

march 2001

new zealand
property
JOURNAL

FACILITIES MANAGEMENT

Where's it, heading?

VALUATION UPDATES

How your thinking affects them

CORPORATE REAL ESTATE

How do we manage it?

RETAINING STAFF

How you, rr, office plays a part

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NZPI's primary objective is to represent the interests of the property profession in New Zealand.

The New Zealand Property Institute:

- Promotes a Code of Ethical Conduct
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- Distributes national NZPI newsletters and email updates
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Submitting articles to the NZPI Property Journal

Notes for Submitted works

Each article considered for publication will be judged upon its worth to the membership and profession. The Editor reserves the right to accept, modify or decline any article. Any manuscript may be assigned anonymously for review by one or more referees. Views expressed by the editor and contributors are not necessarily endorsed by NZPI.

Deadline for contributions is not later than the January 30, May 30 and September 30 of each year.

Format for Contributions

All manuscripts for publishing are to be submitted in hard copy typed double-spaced on one side only of A4 sized paper and also in Microsoft Word document format on IBM compatible 3.5" disk.

Any photographs, diagrams and illustrations intended to be published with an article, must be submitted with the hardcopy. A table of values used to generate graphs must be included to ensure accurate representation. Illustrations should be identified as Figure 1, 2 etc.

A brief (maximum 60 words) profile of the author; a synopsis of the article and a glossy recent photograph of the author should accompany each article.

Manuscripts are to be no longer than 5000 words, or equivalent, including photographs, diagrams, tables, graphs and similar material.

Articles and correspondence for the NZPI Property Journal may be submitted to the editor at the following address: The Editor, NZPI Property Journal, PO Box 27-340, Wellington.

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MUM[PAF ! ,

NZPI Young Property Professional of the Year

This award was created by New Zealand Property Institute Board for recognition of excellence in the field of property by a young professional.

Eligibility Criteria

Members or affiliates of the institute aged 30 years or less shall be eligible.

The criteria for the award is:

- a significant professional participation within NZPI; or
- b original research of outstanding significance; or
- d original authorship of outstanding significance;

AND

d 1) outstanding technical and or professional excellence; or significant contribution to the community that brings credit to the profession.

The research or authorship shall be available to the Editor of the NZPI Property Journal for publication at the board's discretion.

There will be only one national award each year, and this shall only be conferred if the candidate is worthy of the award and shall not be automatic.

The award shall comprise the presentation of an appropriate framed Certificate and Citation and will be presented at the NZPI Annual Conference/AGM.

Initial selection shall be at local branch level with final selection made by the national award panel comprising of the NZPI board of directors.

Nominations may come from any sector within the profession or outside (eg branch committees, councillors, employers, community service groups etc) but may not be by application from prospective awardees,

Nominations for the 2000 award are invited in citation format to the CEO, NZPI, PO Box 27-340, Wellington by April 30, 2001.

EDITORIAL

Welcome to the first edition of the NZPI Property Journal. Our aim in publishing this journal is to replace the NZIV Valuer's journal and to provide for our new broader membership base. This edition is part of the evolution that started many years ago when a combined institute was first mooted, and that evolution will continue.

Whilst maintaining the traditional standard of articles, we aim to challenge the confines of our industry and present new and interesting initiatives through this medium across our broader membership.

The content of our journal touches on a variety of interest areas and has been derived from a number of sources. For this edition we have included the first edition of NZPI Statscom which contains a range of statistical data. Our thanks to those who have contributed to this edition.

NZPI is a new creation and with all our input will develop into something of value and substance. This is also true with the Property Journal. Greatness is not achieved instantly but is received following development and refinement of an entity.

As this publication is a collective journal for all of our members, we would benefit from member input and therefore extend an open invitation for academic works to be submitted for consideration and also article suggestions.

In addition, it would be useful to get feedback on publishing options eg. hard *copy*, CD Rom, web publishing etc.

We are in a period of much transition. This presents challenges but more importantly, opportunities. Your thoughts, ideas and suggestions are warmly invited.

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Clicks and mortar: globalisation, e-commerce and facilities management

Introduction

In the context of this new economy, the sheer velocity of change that we are experiencing can be directly related to two major shifts in the perception of value, rapid globalisation and the instant communications brought to us by tools like the Internet.

Facility managers who understand this value shift and respond to new ways of learning and thinking will find an unlimited future before them. Facility managers who do not, will not survive. Even the term facility manager should be considered fair game for change. Let's explore the pressures and effects that globalisation, the Internet and e-commerce is having on the built environment and our profession as we move to clicks and mortar.

Globalisation: facility arbitrage

The world of facility management is being challenged by the growth and access of the Internet throughout the world. In the same respects local concerns still ring loud and true. What is a facility manager to do? Adoption of thinking globally and acting locally is the mantra for survival, especially in the rapid expansion of global markets for all businesses.

The one main issue that globalisation plays in the context of facility management is that we are working in an era of integration rather than the Cold War context of division. This means that in the past, the strength of countries used to be measured by "how big is your missile", but today, strength is measured by "how fast is your connectivity". Your business should not ask what market should you export your product or service to, after deciding what to produce. Rather, you should first study the global framework in which you operate and then decide what to produce.

Integration of values, culture, processes, tools and people are the greatest challenges that we face in today's New economy. The fact that the world is now a mouse click away should, at first glance, provide us with unlimited imagination while at second glance, it can also provide us with uncertainty. Innovation replaces tradition in our new economic environment. The future replaces the past at frightening speed. One only has to witness the fast erosion of record

companies due to services like Napster to see the speed of destruction of former dominant players. In the age of globalisation, nothing matters so much as what will come next. What is the new, new thing? But what comes next can only arrive if what is here now goes away. It makes for a dynamic and fast system and a terrific place for innovation, but it also makes it a difficult place to live.

Companies that are connected to the Internet are, by default, part of the globalisation economy. Since the Internet does not discriminate in regards to place or time, you automatically become part of the rest of the world by posting your web site or by sending an e-mail. Because of this truth, understanding how the world's traditional countries are operating in this wired world can assist you and your business in gaining insight for your fast decision making as we all journey forward into this unknown land together.

Globalisation is a system that is built around three balances which overlap and affect one another. The first is the traditional balance between nation-states. The notion that nations as we know them will be toppled by the Internet are premature. The United States leads this new order as the sole superpower with all other nations subordinate to it in one way or another. Be it in economics, information technology or fashion tastes, the United States, at this moment in time, has no equal. One can see this in the sheer amount of people that make up the Internet, which runs approximately 75% American. This is changing swiftly as other countries will make up more than 80% of the Internet by the year 2003 (Gartner Group, 1999).

The second balance is between nation states and global markets. Nowhere can this be better illustrated than the collapse of the Asian markets in 1997-1998, which are only now beginning to recover. These global markets are made up millions of investors moving money around the world with the click of a mouse. Tom Friedman, author of "The Lexus and the Olive Tree", calls them "the electronic herd", and this herd gathers in key global financial centers, Wall Street, London, Hong Kong and Frankfurt, which he calls, "supermarkets". The ability, attitudes and actions that a single "herd" member has in today's integrated economy is enormous. A person with an e*Trade

account has the ability to trigger a downfall of a government today. In the past, a country could destroy you by dropping a bomb, but today, the supermarkets, headed by the electronic herd, can destroy you by downgrading your bonds.

The third balance is between individuals and nation-states. Because globalisation has brought down many of the traditional walls that limited the movement and reach of people, and because it has simultaneously wired the world into networks, it gives more power to individuals to influence both markets and nation-states more than any other time in history. Some of these individuals are quite angry, such as the Afgan terrorist Bin-Laden, or some are quite wonderful, like Jody Williams, who won the Nobel Peace Prize for her tireless efforts in banning land mines. These individuals are now able to act directly on the world stage without the traditional mediation of governments, corporations or any other private or public institution.

The balance of these three globalisation balances brings about specific needs that facility managers can fulfill in the context of being a new economy facility arbitrage. An arbitrage is a financial market term that describes someone who simultaneously buys and sells securities, commodities or foreign exchange on different markets, hoping to profit from unequal prices and information. A facility arbitrage would be someone who would "broker" the information between facilities, departments, businesses and markets, leveraging the time and distance differential while using the Internet to gain this advantage. An example would be in the world of real estate transactions, this arbitrage role would reign as king. A facility arbitrage knows how to read the connections between things and connect the dots. To be successful, a facility arbitrage needs to explain like a journalist, yet shape the event like a strategist, ultimately becoming a globalist.

One of the issues that globalisation, and in particular a facility arbitrage, brings is the issue of identity. When forming a global decision, the new economy facility arbitrage has to understand that individual and communal identity run very high in the world of globalisation. Another issue is the striking gap between the slow world and the fast world, sometimes referred to as the digital divide, which increases the anxiety of many upper management types, who sometimes refuse to readjust their lenses and see the opportunities of the global nature of facilities.

A broader issue that affects the idea of a facility arbitrage is the democratization of technology, where everyone is a broadcaster and solid, accurate information can be tough to find. Reliable sources of information are becoming a rare commodity, which is why the emergence of facility managers becoming information brokers should be a fate, not a wish.

General Motors announced in May 2000 it was no longer in the car business, it was in the information business and that all cars were to be considered Internet appliances. GM's new satellite system, OnStar, that keeps drivers from getting lost, is only the first phase of making all GM cars a mobile computer. In essence, the OnStar system can be broadened to conduct transactions, like e-commerce, from anywhere in the world. This means that if you want to order a fast food meal from your car on the way to the fast food restaurant, it can be ordered and paid for through the OnStar system, your only task is to stop by the pick-up window, with GM taking a piece of that transaction. GM is also negotiating with the national gas stations chains to perform a similar, fast transaction. GM estimates that by the year 2004, GM will make more profit through OnStar than by manufacturing cars. The challenge to the new facility arbitrage is, who will be the first to treat their building in a similar manner?

To help frame globalisation into the context of facilities, lets move the globalisation description from nations to business. The pressures of globalisation rest on three balances:

- Traditional balance between businesses
- New balance between businesses and global markets
- Emerging balance between individuals and businesses

For the three balances work in a synergistic and simultaneous manner there must be a network of people, places and things within it to make it work. The main backbone of these balances is the ultimate network, better known as the Internet. The quality and scope of the networking within a business will determine its economic strength. Why is this important?

The fundamental value that a facility arbitrage has is their access to relevant information that make accurate decisions and to manage the three balances of people, places and things. This is the essence of what is known as knowledge management. A better term for knowledge management could be corporate memory, which can lead to better corporate instinct. Your ability to tap into relevant resources that are stored within a corporate memory bank will lead to faster learning, better decisions and increased value. In the world of globalisation, there is a blurring of roles and disciplines. In fact, your IT department should now be considered your facility department and your facility department is now your IT department. They need each other and have untold potential to create the infrastructure, both physically and virtually, that will lead any organization to prosper on the world stage.

e-commerce

The fast paced world of the new economy is

cringing these challenges to the facility manager at unprecedented speed. Combining the skills of fast decision making along with the critical flexibility required to remain competitive in the dotcom world are emerging as key elements for the new economy facility arbitrage. There is no other key enabler that better focuses this area of change than e-commerce. The following four e-commerce methods are meant to be basic solutions that the new economy facility arbitrage must understand to remain competitive.

e-supply chains

The sheer number of dotcom businesses focusing on the facility e-commerce marketplace is staggering. Knowing the stakes are high has led to a gold rush mentality of getting to market first with a solution. So far, there are some good attempts and also some "vapour sites". Some of the pieces that a good e-commerce site should have can be found in other industry examples, most notably the furniture retail and automotive industries.

The interactive nature of the Web screams for a live, online assistant that could help you through a purchase. Taking this cue, furniture.com (<http://www.furniture.com>) has created an e-commerce site that provides visitors with a live assistant that opens a "chat" window to interact with you, if you want to. Furniture.com has 15 design consultants that offer real-time Web assistance to shoppers. After tracking a visitor, a design consultant opens the chat window and offers to help. About 60% of furniture.com's customers accept the offer, where the design consultant can send images or Web pages to the visitor's screen. This provides an interesting dynamic of high tech, high touch that is proving to be highly successful as live, human interaction makes it easier to cross-sell and add value.

Being a "pure Internet play", meaning there are no furniture.com brick and mortar showrooms, works for certain purchases in our industry, but for the majority of us, the Web's promise of e-commerce must be integrated into existing sales channels and supply chains in order to succeed. The e-commerce site that integrates its online ease-of-use with local sales fulfillment centres will provide added value and enhance the industry.

As a facility arbitrage purchaser, a useful e-commerce site would provide *you* with the following:

- Ability to search the available jobs open for bid in your geographic region;
- Ability to research the project;
- Ability to perform accurate quantity take-offs;
- Ability to submit sealed bids;
- Ability to become part of the online Project Team after the bid award;
- Ability to view documents like the project schedule, etc.;
- Ability to be notified in real time about changes

and additions through e-mail, fax and/or beeper/cell phone;

- Ability to purchase products based on the latest project documents;
- Ability to purchase these products based on an auction-style format;
- Ability to pick up the products at your local distributor, or direct to the job site in certain cases.

In the case of the automotive industry the indirect sales, sometimes called the business-to-business (B2B), e-commerce initiatives are providing excellent models of how our industry could work. Through support of the big three car manufacturers (Ford, GM and DaimlerChrysler), an industry wide VPN (Virtual Private Network) called the Automotive Network eXchange (ANX) joins suppliers and buyers up and down the supply chain, allows users to share CAD drawings, provides e-mail, process orders and posts shipping schedules. ANX reduces on the average, 20%-30% of the paperwork traditionally involved with b2b purchases within the automotive industry.

Communication and e-commerce purchases are performed through the ANX authorisation protocols and encryption. Suppliers and purchasers both pay a low subscription fee to become part of ANX. ANX is actually redundantly run by multiple ISP's (Internet Service Providers) ensuring that ANX will remain operational and have redundancy built in as its backup plan. This is an important feature of ANX, as for every hour an automaker's assembly is not operating, the cost is around the \$US1 million range.

The trick to a successful e-commerce site is to identify the existing purchasing behaviours and patterns of customers rather than designing a system online that forces them to buy in a new way. New B2B supply chain and e-commerce methods will develop over time, due to market pressures and technology innovations, but asking purchasers in our industry to abandon existing sales and supply chain channels this early in the process will not succeed.

Aggregated purchasing

Here's a scenario for you. It is September 2000 and you are a facility arbitrage who has just received a quantity takeoff for an upcoming project based on traditional blueprints. You head over to your computer, hop on the web and start putting your quantities into an e-marketplace system that is called aggregated purchasing, in order to get the absolutely lowest prices available by having others also add their purchases to your order.

What's aggregated purchasing? In the context of the above example, it's a Web service that combines anonymous purchasers for the same product in order to get the lowest price. Once you purchase a product, you are in a time countdown that tells you when the purchase will be made. Up until that time, anyone else can get in on the purchase, which drives down the

actual purchase price. The more purchasers, the lower the price. Most sites today have a real-time countdown that you can follow and you will be notified when the purchase is made via e-mail and/or beeper. The volume discounts for certain items in our industry can be enormous, fundamentally changing the power structure of traditional distributors and suppliers. Aggregated purchasing is fast becoming a standard in our industry, but only if focused on local markets with delivery through existing channels.

The fluid commodity nature of these aggregation services change the traditional fixed pricing most of us have been used to. The slowness of changes in pricing is now a thing of the past when put into this context. Speed is now the king when aggregated purchasing is put into practice. Do not be surprised if you find yourself following your aggregated purchasing even closer than following your stocks. Horizontal market examples of aggregated purchase sites include:

- Priceline.com (<http://www.priceline.com>)
- NexTag.com (<http://www.nextag.com>)
- Mercata (<http://www.mercata.com>)
- eWanted.com (<http://www.ewanted.com>)
- Accompany.com (<http://www.accompany.com>)
- Shop2Gether.com (<http://www.shop2gether.com>)
- Zwirl (<http://www.zwirl.com>)

AOL and Yahoo! have also announced their entry into this space within the next few months.

An interesting scenario is if aggregated purchasing pushes beyond products and becomes a more robust way for all services to be bought and sold. An architectural firm could put some of its services up online for a price that could have a "put", meaning an absolute minimum price, and then be bought in "bulk" pricing, ensuring work at that firm, at a fixed level of profit, for a period of time. During economic downturns, this could be a defensive position architectural firms may want to consider.

Reverse auctions

I was witness to a historic event in February 2000 which turned out to be the industry's first "official" auction for goods and services by a government agency. What was seen as an interesting procurement method by some before the auction, turned into the industry's worst nightmare by the end of it. Many in our industry will be wise to be prepared as the technologies of e-commerce are bringing the world of commoditisation to your doorstep, no matter what product you sell or service you provide.

This recent "reverse auction" took place on the web for a state in the northeastern United States. It was for a request for proposal for office furniture. After setting the scope and qualifying the final bidders over a period of two weeks, the bidders were asked to go to a secure extranet website on a given day, at a given time, to participate in a live bid. There were five bidders. They all sat in their own "war rooms"

somewhere in the United States. These war rooms typically consisted of a conference table with a laptop computer hooked up to the Internet with a projection machine pushing the computer screen image up against a white wall. The lights are dimmed, five to eight people enter the room, and the scene is set.

A little bit before noon, each vendor entered the bidding web site by entering their username and password that was provided to them by the state's consulting web auction service, who was conducting the bid auction. These furniture manufacturer's (bidding teams) were also given a guide ahead of time with how the auction would be conducted online, what to expect technically and they also had instant live help by clicking a help button on the bidding web site. After entering the site, each bidding team could see the others name with a zero dollar amount next to the name. The names were vendor 1, vendor 2, vendor 3, vendor 4 and vendor 5 to keep the actual manufacturer anonymous.

At noon, the opening bidding number was posted on the site. \$US14 million was the state's opening bid, meaning, \$14 million was the maximum that the State had determined the worth of the furniture contract. At the same time, a clock started to countdown from 60 minutes. After 6-7 minutes the first volley was launched. Vendor 2 bid \$US13.3 million. Vendor 5 immediately countered with \$US12.9 million. Sweat started to break out across all bidding team members foreheads. Bidding teams quickly consulted with each other across their war room's conference table. Concerned sales people asked their financial people what the absolute lowest bid they could afford to go to. This is called the "floor". Financial people told them their price and the sales people sat back in their chairs, rubbing their chins, knowing already the answer but wanting to be absolutely; positively sure about their "floor price". Many sales people hoped that by seeing the bid "reverse" in price, that the financial people would budge their floor price just a little bit. Each vendor's financial person stared straight at the projected image of the bid auction web site, confident that the price could not fall too much further.

After another eight minutes, vendor 3 posted a bid for \$US12 million. Vendor 1 and 5 countered within seconds, each bidding \$US11.4 million. Then quiet. Fifteen long excruciating minutes past. The people who were running the bid auction site for the state were high fiving each other and the state representatives over the success of the system. Only 30 minutes into the auction and the system had already saved the state's taxpayers \$US2.6 million for this furniture procurement. State officials were already dreaming of what else they could "reverse auction". Design services? Contracting bids? Toilet paper? The possibilities are endless, they thought.

With 23 minutes to go, vendor 4 woke up and bid

\$US8.9 million. The seemingly quiet period was now fully awake. Every two minutes, each vendor took turns in pushing a knife deeper in their own profits by lowering their price. \$US8.87 million. \$US8.57 million. The prices were reaching most vendors "floor price" and the decibel levels in each manufacturer's war room got louder and louder. The sales people began urgently asking the financial people to re-work the numbers on the fly. Some marketing people screamed: "We have to win this bid, it's the first of its kind and we can get the publicity associated with it.". Financial people screamed back that it would not benefit the company to go below the floor price. The management screamed for everyone to remain calm. Other bidding team members slumped in their chairs, staring at the glow of the projector in disbelief that their existence as a furniture manufacturer was made a commodity before their eyes. Their existence was now about a number that is posted to a website.

With nine minutes to go, the pace of bids slowed down and stopped completely for seven minutes. In the war rooms of the five bidding vendors, hands were wringing, sweat was flowing and people began to think about how they were going to explain this whole process to their superiors. With two minutes to go, vendors 2, 3 and 5 hit their escape buttons and were officially out of the bid auction. Vendor 1 put in their final bid at one minute left of \$US7.5 million. Vendor 4 slipped in their bid with 10 seconds left for \$US7.1 million. Vendor 4 "won" the reverse auction.

The numbers and times in this article are skewed a bit so I could tell this story, but this event was real and the actual numbers are accurate in percentages. What is truly frightening about this event was the speed in which decisions were being made by the buyer (the state agency) and the sellers (furniture vendors) during the auction. The ramifications of creating commodity markets based on money savings is now being seriously considered by this particular state, with other states taking a close look at the "success" of this auction. How we all prepare for the economic inevitability of reverse auctions for goods and services is now an immediate strategic task for today's facility arbitrage.

Facility Napster

There has been much coverage lately on a simple technology that allows people to share music files over the Internet called Napster. In essence, Napster is downloaded software that forms an instant network of users who can upload and download MP3 music files. If you are online and have Napster turned on, you can release certain MP3 files to be seen on the Napster network, where others can then choose to download the file to their computer. Because Napster sits in the middle of this transaction, it becomes a routing network to find and download music. In summary if you have Napster turned on and another

person has Napster turned on at the same time while you are both online, you can connect to each other through the Napster network to upload and download music files. This can sometimes be called a Virtual Private Network (VPN).

This has enormous implications for our industry, as a fully deployed Napster-style network would make the existing dotcom portal-style network of web extranets and e-commerce marketplaces immediately obsolete. How would this work?

Say you have a project team that would normally use an extranet for project communications and coordination. If the team all had "facility Napster" installed on their computers, including cell phones and PDA devices, then a project team would only have to set the files they want to share from their computers to form an instant VPN. Once the team members log off, the facility Napster system remembers the last session of users and the files transferred, including any transactions, like from e-commerce. Using this style of service, architects, engineers, GCs, CMs, sub-contractors, vendors and distributors could use their own accounts payable and receivable systems through facility Napster, giving piece of mind that they are not giving up their financial information to a third party extranet service. Users do not need to "go" to any extranet web site and they also do not have to use any other piece of software than what they are used to (CAFM, estimating, scheduling, QuickBooks, ERP, etc.). The ability to transparently be part of a secure, online network without having to use another disruptive online destination website is the heart of the facility Napster concept.

Beyond project teams simply and easily bringing themselves digitally together, the obvious value-add in this concept is the linking of Napster-style information to drawings, product data, code information, etc. Just take out the word MP3 out of the existing Napster service and insert any piece of facility information in its place and you can see the enormous power that the Facility Napster concept has. Facility arbitrage personnel who supply this service correctly first will grow quickly to be one of the powerhouses of the global facility industry.

Convergence of facility management

Integration and convergence of the reality of globalisation with the speed and convenience of numerous e-commerce solutions is having a staggering effect on the traditional role of the facility manager. Not only does the facility manager become a more strategic player in the vision, operations and growth of a business, but can have an immediate effect on the bottom line through a properly implemented and maintained e-commerce plan.

One of the more intriguing effects of this convergence is in the world of e-procurement and e-invoicing. One of the world's largest investment

banks decided in 1998 to move its numerous offices in lower downtown Manhattan to Times Square, including its three trading floors. The 60-storey tower was slated for a December 1999 break ground date, with the deadline for completion in June 2001. Early estimates had the project coming in at \$US600 million. What the owner received was much higher. Why? The booming economy of New York city had the trades busy, thus not giving their best bid price.

At the same time as the early bids were solicited, a study was conducted showing the investment bank was spending internally on the average \$US150 per cheque for processing of an invoice. Another study also showed the average time a trade was paid on a project of this scale was 120 days. With these two metrics available, the facility arbitrage within the investment bank went to work on finding the process and tools that could help bring these two seemingly disparate facts into a convergent solution. By using a combination of a global understanding that environments like the Internet knows no geography or time, along with the fast, secure communication of e-commerce style transactions, the facility arbitrage created a team that developed an e-procurement/e-invoicing system called CIIPS, the Cost Invoice Information Processing System. CIIPS allows subcontractors to submit their invoice digitally through a secure web site. Once submitted, CIIPS provides a

digital workflow approval process for the invoice that ends with direct deposit into the sub-contractor's bank account.

When it was fully implemented in the fall of 1999 (in time for the groundbreaking of the new building), CIIPS had reduced the cost of processing an invoice to under \$1 and reduced the time for direct payment to a subcontractor's bank account to an average of five days. The facility arbitrage, in this case, used the tools of the Internet and the world of local solutions to leverage the global nature of Web to create immediate value and reduce costs.

Summary

The traditional role of a facility manager is over. Attempts to slowly transition into expanded roles while maintaining the past is like painting a room when an entire new building and foundation is needed. The new architecture that is necessary involves a solid understanding of the effects of globalisation (increased networking, new relationships, fast access to relevant information) and e-commerce (auctions, aggregated purchasing, VPN's). Once learned, the new economy facility arbitrage will increase in value and provide a viable future for the profession.

This *article* was *presented* at the International Facility Management Association's *World Workplace Conference 2000*.

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Cognitive biases and the updating of valuations

Introduction

This paper reports the results of experiments that tested whether valuers are influenced by earlier value figures and whether they have a greater tendency to adjust previous valuations upwards rather than downwards. The initial experiments were carried out with student valuers. The results of this experiment were reported in an earlier paper (Havard, 1999). A subsequent experiment was carried out with a group of practicing valuers, which confirmed the earlier observations. The research was carried out as part of a process aimed at examining some of the factors that influence commercial valuers and which may influence the outcome of a valuation.

Background

Valuers often carry out valuation work where they have some knowledge of value or transaction price on the property they are dealing with. Two very important types of valuation work, namely investment asset valuation and loan security valuations, frequently allow valuers to have such prior knowledge. Valuers for investors such as life assurance and pension funds often update earlier valuations or else carry out fresh valuations with the knowledge of a previous valuation. Valuers carrying out loan security valuations are frequently either told or find out the actual transaction price on the property.

Recent work has suggested that valuers can be affected by prior knowledge of price or value (Diaz and Hansz (1997), Black (1997), Diaz and Wolverton (1998), Havard (1998) and Gallimore and Wolverton (1997)). The knowledge of price and value acts as an anchor or starting point for the valuer that can bias the resulting valuation and represents the adoption of an heuristic strategy (Tversky and Kahneman (1974) and Einhorn and Hogarth (1988)).

How heuristics affect decision making is briefly discussed below

Decision making and Heuristics

Research from the field of cognitive psychology has provided an understanding of how human beings reach decisions. Of particular relevance to valuations is how human decision-makers operate in complex environments where the outcome of the task is uncertain. In these situations humans adopt cognitive

short-cuts known as heuristics to ease the burden of information processing (Tversky and Kahneman, 1974, Evans, 1989). The use of heuristics, often distinguishes expert from novice decision-making behaviour, their use generally improves the efficiency of the decision making process (Hardin, 1997). In certain circumstances, however, heuristic use can lead to biased or inefficient decisions, for example, studies in the accountancy and auditing areas have revealed examples of both heuristic use and biased decisions (Assere, 1992, Krull, Reckers, Wong-on-Wing, 1993). Similar outcomes have been found to exist in the real estate field, mainly with residential appraisal or valuation (Gallimore, 1994, 1996, Diaz III, 1997).

Heuristics can be defined as rules or patterns which help to reduce the complexity of decision making (Wooford, 1985). Many researchers have found that heuristics, or rules of thumb in decision making, are often resorted to by humans facing complex situations (e.g. Ashton and Ashton, 1988; Tubbs et al, 1990). Hardin (1997) notes that, when properly applied, information-processing heuristics reduce the search time and thus the time required to complete the task. Tversky and Kahneman (1974) identified three main types of heuristics. Evans (1989) later added a fourth. Other, lesser heuristics have subsequently been identified. The four main heuristics used in problem solving are:

The representative heuristic

The representative heuristic is similar to stereotyping. A decision-maker classifies an event or object with others of a type that they are familiar with. Lessons are learned from experience and assumptions are made that the subject in a task is the same as that seen elsewhere.

The availability heuristic

With the availability heuristic the decision is framed according to the experience the decision-maker has had in the past with the type of problem or situation. An apparently successful strategy or solution of the problem means that tasks will tend to be perceived in a certain way once essential components have been recognised. Once this behaviour has been learned, it is very hard to alter. Data collection tends to be based around ease of retrieval, the decision-maker will choose the most

recent information or the information most easily recalled or obtained.

The anchoring and adjustment heuristic

The anchoring and adjustment heuristic was identified by observing that problems tended to be solved by decision-makers arriving at an initial estimate. This initial estimate is then adjusted as more information is obtained until a final solution is reached.

The positivity heuristic

The positivity bias was identified after it was noted that humans have a fundamental tendency to seek information consistent with their current beliefs. They adopt strategies that are designed to confirm rather than refute beliefs.

Whilst it seems likely that all of the above heuristics may be used in decision making in valuation the majority of published studies have concentrated on the anchoring and adjustment heuristic. Gallimore (1994), Diaz and Wolverton (1998), Black and Diaz (1996) and Diaz and Hansz (1997) have all found evidence of anchoring and adjustment used by valuers in the valuation process.

The question examined in this research

The paper by Diaz and Wolverton is particularly relevant in this context. The authors examined the appraisal-smoothing phenomenon from a behavioural viewpoint. They found that valuers adjusted insufficiently from a self generated prior anchor. The research reported in this paper examines further aspects of this. The specific question dealt with in this paper is whether valuers have a greater tendency to adjust a low previous valuation upwards or a high previous valuation downwards.

The importance of this question is related to the two key valuation functions mentioned above. With repeatedly valued investment properties held within funds there is a question whether valuers, either internal or external, are more willing to adjust a valuation up in a rising market than to adjust down in a falling market. This question relates to the valuation smoothing phenomena that Diaz and Wolverton examined. With loan security valuations, it is essential for the lender that the property represents good security for the loan and that the valuation is, therefore, not excessive. If the transaction price is higher than that which market evidence would suggest was rational the valuer might not adjust his or her opinion of value down sufficiently.

The initial experiments reported in this paper used student appraisers to see if they illustrate a bias against adjusting valuations downwards. A subsequent experiment utilised a group of experienced valuers.

Methodology

Objective and research hypothesis

The objective of this research was to find empirical support for the idea that valuers are more willing to

adjust a low valuation upwards than to adjust a high valuation downwards.

To meet this objective a two-stage experiment was designed. The first stage required a group of valuers to value a property at a given date of valuation using supplied data. This provided a control valuation. The second stage of the experiment required two further groups of valuers to value the same property using the same information set. All of the groups were told that they were carrying out an annual asset valuation on the property for inclusion in the year end accounts of a property investment company. Amongst the information supplied to each of the second was a valuation dated 12 months earlier. For one group (Treatment group A) this figure was a low valuation, for the second group (Treatment group B) the figure was a high valuation. The distribution of the valuations produced by each group was then analysed.

The research hypothesis was therefore as follows: -

A group of valuers carrying out a valuation of a property interest, where they have prior knowledge of a previous valuation carried out on the same property interest, will illustrate a higher level of upward adjustment where the previous valuation was at a low level than the corresponding downward adjustment made by a similar group of valuers who have knowledge of a high previous valuation.

In a capital valuation of a simple investment property, the capital value (CV) is itself a product of the combination of the estimated rental value (ERV) and the initial yield (IY). The research hypothesis was tested by examining these three components of the valuation.

Specifically, the validity of this hypothesis was tested in two ways. Firstly the overall level of adjustment in ERV, IY and CV made by treatment group A were compared with those made by treatment group B. If the research hypothesis were correct it would be expected that the adjustments made by group A would be greater. The statistical significance of the distributions of the valuation components illustrated by the two groups was tested using the following null hypotheses: -

Ha ERV The adjustments in ERV from the level of the previous valuation for the low valuation anchor group (treatment group A) are less than or equal to the adjustments made by the high valuation anchor group (treatment group B)

Hon The adjustments in IY from the level of the previous valuation for the low valuation anchor group (treatment group A) are less than or equal to the adjustments made by the high valuation anchor group (treatment group B)

Ho cv The adjustments in CV from the level of the previous valuation for the low valuation anchor group (treatment group A) are less than or equal to the adjustments made by the high valuation anchor group (treatment group B)

If a difference is found in the distribution of the valuation components produced by the two groups and the null hypotheses are rejected then the alternative hypothesis can be supported.

Additional tests of the research hypothesis were possible with the preliminary experiment because of the valuations produced by the control group. The valuations produced by the two treatment groups can be compared to this third group to determine whether the adjustments made by the groups are sufficient. Given the overall research hypothesis it would be expected that group A would make a sufficient adjustment whilst group B would make an insufficient adjustment. The following pairs of null hypothesis were therefore tested: -

PAIR ONE

H. $ERV_{tgA/con}$ The median ERV of treatment group A is equal to the median ERV produced by the control group.

H. $ERV_{tgB/con}$ The median ERV of treatment group B is equal to the median ERV produced by the control group.

PAIR TWO

H_o $tY_{tgA/con}$ The median IY of treatment group A is equal to the median ERV produced by the control group.

H_o $tY_{tgB/con}$ The median IY of treatment group B is equal to the median ERV produced by the control group.

PAIR THREE

H_o CV_{tgvcon} The median CV of treatment group A is equal to the median ERV produced by the control group.

H_o $CV_{tga'con}$ The median CV of treatment group B is equal to the median ERV produced by the control group.

This same basic approach was applied to both sets of experiments except that with the practitioners there was no original "control" valuation. The valuations provided to each group were prepared by the researcher based upon current market evidence. This

was due to the circumstances in which this experiment was conducted, as outlined below

Data collection

Both experiments comprised a simulated desk valuation of an investment industrial property located in Warrington, England.

Preliminary experiment: student valuers

Student valuers were chosen for the initial study for a number of reasons. Principally this was connected with data collection issues. The study required a reasonable sample of participants (in this case 30) to undertake the valuations within a relatively short time period to ensure that the participants assumptions relative to wider market conditions were similar. The author also wished to control for the effects of different levels of specific and general levels of market experience held by the participants. Both of these characteristics are difficult to achieve with a sample of practising valuers.

The choice of student valuers as opposed to practising valuers does however weaken the validity of the results as regards their applicability to practice. Although traits in decision making may be inherent and carried into practice, there is no doubt that experienced professionals tend to work very differently from those without experience (see Diaz, 1990). This study was, however, always intended as a preliminary study that is intended to highlight areas of potential weakness in practice and suggests avenues for further research.

Data was collected from 30 participants in total. The participants were final year valuation students from Nottingham Trent University and Herriot Watt University. Each participant worked alone on the valuation. The valuations were carried out on May 21 (Control Group Nottingham Trent University) and June 4/5, 1998 (Treatment Groups A and B Herriot-Watt University). A single researcher conducted the experiments. The participants were informed that the experiments were related to behavioural aspects of valuation but were not specifically briefed as to the purpose of these experiments. Each participant was asked as to his or her level of knowledge regarding the

location of the subject property. Anyone with knowledge of the specific market was excluded from the sample.

Each of the participants received an A4 sheet detailing the valuation instructions. The participants were all given a verbal briefing on the location that was given by the researcher working from a prepared script. Details of the property to be valued were provided including photographs description and location plans. Details of ten pieces of transaction evidence were provided to each participant. These also included photographs, descriptions and location plans. The treatment groups also received a sheet detailing the previous year's valuation of the property (see Table 1). This valuation was either "high" or "low" depending on which of the treatment groups the participant was allocated to. The participants were given a maximum of 10 minutes to complete the task.

Experiment with practising valuers

The experiment with practising valuers utilised the same subject property and initial valuation details but took a different form because of the nature of the environment in which the data was collected. The data was collected during the Millennium Valuation conference of the independent expert and arbitrators (ARBRIX/INDEX) in November 1999. The experiment took place at the beginning of a presentation on the author's research. Of an audience of approximately 100, 39 valuers took part in the exercise.

As in the student experiment above, each of the participants received an A4 sheet detailing the

valuation instructions. The participants were all given a verbal and on-screen briefing on the location that was given by the researcher working from a prepared script. Details of the property to be valued were provided including photographs description and location plans. Details of five pieces of transaction evidence were displayed by way of an on-screen presentation to the group as a whole. These included photographs, descriptions and location plans. The treatment groups also received a sheet detailing the previous year's valuation of the property. This valuation was either "high" or "low" depending on which of the treatment groups the participant was allocated to. The group were asked not to disclose this information to the person sitting alongside them nor to discuss the valuation or its issues whilst the task was undertaken. In fact the audience was divided into two using a central aisle as a division with one side of the room receiving the "high" previous valuation, the other the "low". The participants were given a maximum of 10 minutes to complete the task that comprised an estimate of the current valuation figure.

Results

Student experiment

Preliminary valuation control group

The results of the valuations of the Control Group are presented below (Table 2). As noted above, this valuation was used to set the parameters of the information presented to Treatment Groups A and B. The "previous year's valuation" was calculated by using

the standard deviations for the estimated rental value (ERV) and initial yield (IY) estimations of the control group. For ERV, three standard deviations were respectively added or subtracted from the control group mean valuation for the "high" or "low" valuation. Similarly, for initial yield, two standard deviations were either added or subtracted. After rounding, this gave figures of £28/m² and 11% for the "low" valuation and £42/m² and 7.75% for the "high" valuation (see table 3).

Main valuation tasks Treatment Groups A and B

The results of the subsequent valuations carried out by the treatment groups are detailed below (table 4a and 4b). The distributions of the results of the groups were analysed using the non-parametric Mann-Witney U-Test.

Comparison of level of adjustment in ERV, IY and CV made by Treatment Groups A and B from previous year's valuation.

The median adjustment in ERV from that used in the previous year's valuation made by Treatment Group A (low value anchor) was £7.00/m². The

median adjustment in ERV from that used in the previous year's valuation made by Treatment Group B (high value anchor) was 0.50/M². Using the Mann-Witney U-test the difference was found to be significant at the 5% level (U = 18, critical value of U, one-tailed at 5%, =271) and that the null hypothesis HoERV should be rejected. The alternative hypothesis that Treatment Group A made a significantly greater adjustment in ERV from the previous year's valuation than Treatment Group B is accepted.

The median adjustment in IY from that used in the previous year's valuation made by Treatment Group A (low value anchor) was 0.88%. The median adjustment in ERV from that used in the previous year's valuation made by Treatment Group B (high value anchor) was 0.38%. Using the Mann-Witney U-test the difference was found to be significant at the 5% level (U = 24.5, critical value of U, one-tailed at 5%, =27) and that the null hypothesis HoIY should be rejected. The alternative hypothesis that Treatment Group A made a significantly greater adjustment in IY

TABLE 4A: SUMMARY OF THE VALUATIONS CARRIED OUT BY THE CONTROL GROUP AND TREATMENT GROUPS A AND B MEAN RESULTS

TABLE 4B: SUMMARY OF THE VALUATIONS CARRIED OUT BY THE CONTROL GROUP AND TREATMENT GROUPS A AND B MEDIAN RESULTS"

k)

TABLE 5A: SUMMARY OF THE EVALUATION IS CARRIED OUT BY THE PRWIFIN
 MEAN RESULTS: f

TABLE 5B SUMMARY OF THE EVALUATION IS CARRIED OUT BY THE PRWIFIN
 MEAN RESULTS: f

from the previous year's valuation than Treatment Group B is accepted.

The median adjustment in CV from that used in the previous year's valuation made by Treatment Group A (low value anchor) was £88.18/m². The median adjustment in CV from that used in the previous year's valuation made by Treatment Group B (high value anchor) was £64.22/m². Using the Mann-Witney U-test the difference was found to be significant at the 5% level (U = 24, critical value of U, one-tailed at 5%, =27) and that the null hypothesis HoCV should be rejected. The alternative hypothesis that Treatment Group A made a significantly greater adjustment in ERV from the previous year's valuation than Treatment Group B is accepted.

Comparison between ERV, IY and CV assessments of Control Group and Treatment Groups A and B.

The median ERV assessment was £35.00/m² for the Control Group, £35.00/m² for Treatment Group A

and £38.50 for Treatment Group B. The null hypothesis that there is no difference between the Control Group and Treatment Group A (Ho ERV tgA/Con) cannot be rejected (U = 42.5, critical value of U at p = 5% (two-tailed) is 232). The null hypothesis that there is no difference between the Control Group and Treatment Group B (Ho ERV tgB/Con) is rejected (U = 23, critical value of U at p = 5% (two-tailed) is 23). The ERV assessment of Treatment Group B is significantly different from that of the Control Group. Whilst the adjustment made by Treatment Group A was sufficient, the adjustment made by Treatment Group B was insufficient.

The median IY assessment was 9.25% for the Control Group, 10.13% for Treatment Group A and 8.13% for Treatment Group B. The null hypothesis that there is no difference between the Control Group and Treatment Group A (Ho IY tgA/Con) cannot be rejected (U = 34.5, critical value of U at p = 5% (two-tailed) is 23). The null hypothesis that there is no

difference between the Control Group and Treatment Group B (Ho IY tgB/Con) is rejected ($U = 1$, critical value of U at $p = 5\%$ (two-tailed) is 23). The IY assessment of Treatment Group B is significantly different from that of the Control Group. Whilst the adjustment made by Treatment Group A was sufficient, the adjustment made by Treatment Group B was insufficient.

The median CV assessment was f-389.19/ml for the Control Group, £342.73/m² for Treatment Group A and £477.72 for Treatment Group B. The null hypothesis that there is no difference between the Control Group and Treatment Group A (Ho CV tgA/Con) cannot be rejected ($U = 41.5$, critical value of U at $p = 5\%$ (two-tailed) is 23). The null hypothesis that there is no difference between the Control Group and Treatment Group B (Ho CV tgB/Con) is rejected ($U = 3.5$, critical value of U at $p = 5\%$ (two-tailed) is 23). The CV assessment of Treatment Group B is significantly different from that of the Control Group. Whilst the adjustment made by Treatment Group A was sufficient, the adjustment made by Treatment Group B was insufficient.

Experiment with practitioners

The results of the subsequent valuations carried out by the treatment groups are detailed below (table 6a and 6b). The distributions of the results of the groups were analysed using the non-parametric Mann-Witney U-Test.

Comparison of level of adjustment in ERV, IY and CV made by Treatment Groups A and B from previous year's valuation

The median adjustment in ERV from that used in the previous year's valuation made by Treatment Group A (low value anchor) was +£2.00/m². The median adjustment in ERV from that used in the previous year's valuation made by Treatment Group B (high value anchor) was -L2.00/ m². Using the Mann-Witney U-test the difference was found to be significant at the 5% level ($U = 224$, critical value of U , two-tailed at 5%, =983). The groups therefore produced valuations that were significantly different from each other but the hypothesis that the adjustment would be greater for one group must be rejected.

The median adjustment in IY from that used in the previous year's valuation made by Treatment Group A (low value anchor) was -0.25%. The median adjustment in ERV from that used in the previous year's valuation made by Treatment Group B (high value anchor) was 0.50%. Using the Mann-Witney U-test the difference was found to be significant at the 5% level ($U = 204$, critical value of U , two-tailed at 5%, =98). The groups therefore produced valuations that were significantly different from each other but the hypothesis that the adjustment would be greater for one group must be rejected.

The median adjustment in CV from that used in the previous years valuation was not tested.

Discussion and conclusions

The results of the analysis confirm the hypothesis that student valuers have a greater tendency to adjust a previous valuation upwards than to adjust a previous valuation downwards, all other things being held constant.

The experts tested in the subsequent experiment produced a slightly different set of results. The Mann-Witney U test showed that these valuers, who had no prior experience of the location, were strongly biased by the previous valuation figure. They did not, however, have a tendency to adjust the "low" valuation up to a greater degree. This may have been due to the gap between the "low" and "high" valuations being narrower than with the student experiments. This aspect needs to be explored further in future research.

These observations confirm some earlier work from the U.S. Diaz (1997), for example, found that there was no evidence that experienced valuers working in familiar areas were influenced by the previous value judgements of anonymous experts however Diaz and Hansz (1997) found that subjects were influenced when working in areas of unfamiliarity. They do, however, raise further questions in their own right about the effect of their experienced, "expert" status on the effect of the biasing data. This factor requires further research with expert valuers under controlled conditions in the field.

The confirmation that expert valuers can be biased is also a very significant finding in its own right. It raises further issues about the reliability of valuations as well as adding a new aspect to the work of Crosby et al (2000) into the effect of client influence on valuations. The experimental work to date has only scratched the surface of what must be a key area of concern to commercial valuers and substantial further work is required.

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1 For samples of n1 = 10 and n2 = 10

2 For samples of n1 = 10 and n2 = 10

3 For samples of n1 = 21 and n2 = 18

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Corporate real estate asset management

Introduction

The areas of corporate real estate and corporate real estate management have been fairly widely discussed over the past decade. Even so it is still an emerging, evolving and ever changing property area.

What corporate real estate (CRE) and corporate real estate management (CREM) are have been well defined, but where they sit in relation to company structure and what skills and competencies are required to manage them is still in debate.

The role of corporate real estate in a corporation is crucial, but has often been pushed into the background by the more high profile units, such as marketing, finance and information technology. No corporation can function without property and it will definitely appear somewhere on the balance sheet.

The corporate real estate management unit's place in the corporation structure becomes important when linked to the long term strategic planning of the corporation. This together with the functions and practices of the CRE unit must be defined to add value to the corporation's bottom line. To help add this value, outsourcing was, and to some extent still is seen as a good cost saving mechanism. Today, the reasons for outsourcing have changed somewhat. With the emergence and recognition of specific CRE units, the skills and competencies required of CRE unit managers and members have changed.

Are CRE unit managers and members just glorified property and facility managers? Do these CRE people need skills and competencies at an upper management level to function in the corporate environment?

In response to the above this article will discuss these issues, placing the CRE unit in the corporation structure, detail the functions and finally investigate the skills and competencies of CRE unit members.

Corporate real estate management defined

Corporate real estate management was defined by Zeckhauser & Silverman (1983) as, the management of the real estate assets and related personnel of those organisations whose primary area of business is other than real estate. Kenley et al., 2000 described it as management of real estate by an organisation which incidentally holds, owns or leases real estate to support its corporate mission (from Rondeau 1992:1, Bon et al.

1998:209, Brown et al., 1993). The statement is also made by Kenley et al., that, "The primary value to the organisation is not the investment value of the property but is contribution to the way it does business".

The definition of corporate real estate does not include corporations or organisations that hold real estate as the main portion or part of their investment strategy. That is property trusts (real estate investment trusts), superannuation funds (pension funds). For the purposes of this article it does not include public real estate.

Adendorf & Nkado(1996) comment that: "Most corporations list real estate holdings in the property, plant and equipment part of the asset section of the corporation balance sheets. They are accounted for at their historical acquisition and financing costs, a valuation that is not a true reflection of their current value."

Preliminary research indicates that the balance sheets vary from country to country with differing approaches and standards for accounting practice that makes the role of the CREM unit even more important.

Although comments have been made by those who have been surveyed, such as, "we are not in the real estate business", it becomes apparent that no firm can function without real estate, either leased or owned. It is how the real estate is used and the management of it, to the best advantage of the corporation that is of prime importance.

The role of corporate real estate

The percentages of corporate real estate that comprise an organisations assets seem to vary greatly. Again, as early as 1983, Zeckhauser & Silverman identified that between 25% and 41% of corporate assets were real estate. (North America). In 1992, Flegel estimated that between 20% & 35% of all US corporations assets were real estate.

The most recent evidence from Australia by Kenley et al (2000, p.20) stated that, "On average Australian organisations own a higher proportion of their real estate (65%) than European and North American organisations (49%). Therefore, in Australia property costs make a higher proportion of organisations' annual operating costs. However the share of the

property in total company assets is virtually identical with Europe and North America. This suggests that European and North American organisations are managing their CRE more efficiently and with greater profit than Australian organisations, and is further evidence that there is less use of CRE tools in Australia. The average time horizon for long term planning in Australia (4.9 years) is very similar to Europe and North America (4.6 years)."

What does all of the beforementioned really tell us? It simply means that real estate, like it or not, is an integral part of any corporation's business and sometimes a large part of it. The most important fact to emerge is that the real estate assets must be managed properly and fit in with the overall corporation strategy. Ultimately, the effectiveness of

the corporate real estate function relies upon connecting real property transactions to the overall corporate strategy aided by an explicit corporate real estate strategy. (Nourse & Roulac, 1993). To undertake this, the corporate real estate unit (or CRE unit) becomes an essential part of any corporation.

Corporate real estate management unit

Many national, international and multi-national corporations have set up specific CREM units in the past decade. Where these units are placed in the management structure varies, but an overall picture can be gained through the following diagram. This diagram is based on those put forward by Bentley (2000, p.9) and Kenley et al., (2000, p.8).

Property/real estate investment trusts. Superannuation and pension funds

Fund manager sets a macro framework for the property investment.

Asset manager provides the strategic framework for the investment

Corporate real estate asset management

Senior Management sets a macro framework for the corporations real estate needs.

Corporate real estate unit provides strategic framework for the corporation's real property needs.

V

Property management firm/manager ensures that the strategy is implemented.

Facilities manager, facilities management firm ensures physical work is carried out.

Marketing unit requirements

Manufacturing unit requirements

Corporate real estate unit provides strategic framework and options for the corporation's real estate needs for all/each unit/section.

Human resources unit requirements

Information technology unit requirements

Property outsource providers. One or several firms providing a suite of real property services, could include facilities management.

Facilities manager/management firm ensures physical work is carried out.

Before discussing the functions and practices of the CRE unit, it might be helpful to further explore its place in the corporation structure, on a more detailed basis.

The preceding diagram centralises the CRE unit to show its overall importance in the corporation's operations. The effectiveness of the corporate real estate units' function relies upon connecting real property transactions in each of the units. The flow or information and planning (real estate) needs is crucial. This requires more effectively aligning the CRE function with corporate objectives and the goals of business units during a period of rapidly changing business practices. (Manning & Roulac, 1996).

It becomes quite apparent that the corporate real estate strategy of a large corporation is ever changing and therefore the functions and practices of the CRE unit must be able to adapt for success. The long-term planning periods mentioned earlier, do not leave a large horizon for adjusting real estate strategies.

Function of the CRE unit

Many papers have included sections on the functions of the CRE unit. Papers by McKellar (1998), Manning, Rodriguez & Ghosh (1999), Cam, Black & Rabianski (1999), Schaefer (1999) and Gibson & Lizieria (1999) detail many of these functions

How the CRE unit is set up depends upon the company structure, but Krumm (1999), suggested, after a preliminary study, that two possible scenarios existed. Firstly, the centralised scenario. There is one CRE unit responsible for all real estate matters (country wide/world wide). Secondly, geographically centred CRE units. Each area (state, region, country) has a CRE unit. They may or may not report back to the centralised CRE unit. Krumm went on to state that the second scenario had many advantages in that "the local, state and country laws differed greatly and local knowledge of these matters and the prevailing market was essential to add value to the corporation's bottom line".

Kenley et al (2000, p.9) set up similar scenarios on

a centralised basis, viz.,

- Centralised-global: the firm is organised as global functional business units (global in terms of world geography as well as global in the sense of being organisation wide).
- Centralised-geographic spread: the CRE unit is centralised in an organisation that has geographically based units as well as business functional units.
- Separate property company.

The scenarios put forward become more important when considering outsourcing. Even back in 1990, Raney (p.15) stated that it is important internationally to have local real estate talent familiar with local laws, markets and business operations, supported by the greater expertise and information capabilities of a centralised CRE unit.

This may indicate that it is better to have small regional CRE units, with detailed local knowledge and rely on outsourcing for the majority of the CRE day-to-day functions.

Outsourcing of CRE practises

Since the early to mid 1990s more corporations have been outsourcing their real estate requirements and the providers of these services are being forced to increase their staff size. As early as 1993 corporate executives realised that as real estate showed up as a number-two or a number-three line item cost, they started looking for ways to reduce the real estate cost (Walton, 1993, p.26).

This process, or so it was thought, of just reducing costs, also allowed more focus on the core business. The concept of outsourcing was also referred to by many, as, right-sizing, out-tasking, downsizing, re-engineering, and delayering. This did not mean closing the corporate real estate unit, it meant that real estate staff had to remain to carry out the planning strategy and overseeing the process, rather than be involved in implementing of the day-to-day activities. These day-to-day tasks would be outsourced.

A survey carried out by McDonagh & Hayward and reported on in 2000 (p.9), indicated that the extent of outsourcing was not dissimilar to figures revealed earlier by Kimbler and Rutherford in 1993. For 43% of organisations outsourcing was now more common than five year ago, whereas 7% were outsourcing less, leaving 50% with an unchanged level.

One area that is constantly commented upon is that of the quality of services (hence staff) offered by the outsource providers. Many respondents (corporations) have indicated through various surveys that they were now more concerned with the quality of services than the price. It appears that companies are now looking toward building long-term relationships with quality service providers.

To build the long term relationships the corporate real estate goals and objectives (and strategies) must be

known in detail by the CRE unit, so that the appropriate strategies can be coordinated (Addendorf & Nkado, 1996 p.71).

Kimble & Rutherford (1993, p.257) found that corporations prefer to work with providers they know, that the quality of the employee who will be assigned to the project is important and that long-term relationships become important to both the service providers and the corporate managers. McDonagh & Hayward (2000, p.11) found that there is a clear indication that access to skills, technology and best practice not available in the organisation are the main outsourcing reasons for most organisations and that, contrary to popular belief, cost savings are now relatively unimportant.

Corporate real estate managers' skills and competencies

Kooymans (2000, p.12) states that, "some outsource service provider executives could see no difference between corporate real estate management and property management". What does become obvious is that outsourcing is here to stay and the skills required to be an outsource provider have changed and the skills to be in the CRE unit are definitely different (more advanced). Each corporation will have different goals, objectives and strategies but the CRE unit will require more sophisticated outsource service providers.

The availability of quality staff with the required skills may be a problem for these service providers. For many years (decades), property companies (real estate service providers) have regarded the property management section (and that is how many service provider companies view their employees giving CRE unit support) as a low paid stepping stone department, in the real estate profession. An interesting comment was made by Kenley et al. (2000, p.28), that many interviewees expressed, that, historically people were assigned to property roles because they might be detrimental to company performance in other portfolios. People were assigned there (to property roles), because it was felt that they could do the least amount of damage in such a role. This type of thinking, again, is still probably prevalent in many companies.

The CRE unit needs people who can add value to the corporation, that is, have a definite effect on the bottom line. The questions are, where do these people come from and what attributes do they need? It is quite possible that CRE unit members and managers will come from two sources.

Firstly from within the corporation and secondly from outside firms. (More than likely service provider firms).

Kenley et al. (2000, p28) also state that a thorough working knowledge of property management (valuation, project management, leasing, zoning,

Existing employees.
Corporation culture, but
with little property
experience.

00 CRE Unit.

Service providers with
quality property skills and
knowledge of corporate
structure.

legislation etc), and the property market is imperative". These property skills will only come from those people who have the right training and experience. This really starts to point toward the service providers as being the source for future CRE staff. This also opens a career path for those in the property industry. In today's job market 'head hunting' is common and if the rewards are there, both in job satisfaction and in monetary terms, this movement will definitely occur. It may not be that the corporation will take someone from their own service provider that is working with them, it will mean that there is a bigger, better pool of qualified people to draw from.

At this upper end of corporate management many firms may feel the need to have people with MBA or other Masters qualifications, so that they know they will have the necessary theoretical skills as well the practical (people) skills. This is especially true of the CRE unit. Kenley et al (2000, p.29) indicate that the skills required by CRE managers include: Organisational awareness, team player, business and financial skills, people skills, property skills, conflict resolution and negotiation skills and communication skills.

The question does arise, that if the CRE manager is expected to have an MBA qualification, what MBA course offers a property subject as a core or elective? Existing undergraduate and postgraduate courses in property equip their graduates with the necessary skills to enter the corporate real estate area, but most MBA programs seem to view the fact that corporations can function without real estate.

Conclusions

No corporation can function without real estate, whether it is leased or owned. This real estate component is tangible and affects the bottom line of the corporation. It is an integral part of the corporation but for many years was overlooked as a value added asset.

The corporate real estate must be managed by the CRE unit to fit in with the overall corporation strategy. The CRE unit must identify the most effective, efficient and practical ways of maximising the property value.

As all corporations change, their strategies change and the CRE unit must be able to adapt rapidly to them. New working practices, such as tele-working,

home offices, office intensification etc., will cause a major upheaval in the need for business space (real estate). The CRE unit needs good communications with all corporation units to plan for this. The placement of the CRE unit in the corporation structure and the strategy it adopts are crucial for success. It appears the centralised CRE unit, with geographically spread units and specific local knowledge is the preferred model.

To cope with this rapidly changing role many day-to-day tasks must be outsourced. Outsourcing is here to stay and it is a growth area. The service providers need quality staff to establish long term, profitable relationships with the corporations. As has been stated, cost is no longer the primary driving factor behind choosing a service provider, rather the quality and comprehensiveness of services offered is paramount. To meet this demand for services the staff, of both the CRE unit and the service providers, need to be well trained. Educational courses must be available to meet this.

There is now a clear hierarchical management structure for property management staff and the roles they undertake become just as clearly defined.

The future for all those wishing to enter the corporate real estate management profession is looking assured. The rewards are there in job satisfaction. The question is, are the monetary rewards commensurate to this complex upper management task?

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Using offices to attract and retain employees

Government data confirm that employers' costs to attract and retain employees at all levels rose in the year ended June 30 at the greatest rate since 1993. The Employment Cost Index for all civilian workers which measures changes in compensation costs, including wages, salaries and employer costs for benefits rose 3.5% for the 12 months through June, 1998, according to the Bureau of Labor Statistics.

In a 1998 survey of most admired companies, Fortune Magazine reports, "The single best predictor of overall excellence was a company's ability to attract, motivate and retain talented people." It's no longer enough for companies to pay well and offer competitive benefits in order to succeed in attracting and retaining employees. While these factors are important, if companies want to attract, retain, and motivate employees, they must also create a work environment that gives them a competitive edge.

"The next decade will really be the decade of the employee," said Wallace J. Nichols, executive director of the American Compensation Association, a 23,000-member industry group in Scottsdale, Ariz. "Low inflation, low unemployment, continuing scarcity of qualified workers and an increase in real wages are all combining to put employees in the driver's seat."

The quality of the office workplace and its furniture is one of many factors that can help attract and retain employees. The ambience of the office and its furniture make a statement about a company's corporate culture. If the corporation's facilities contain:

- An office design that is purposefully created to reduce stress and increase productivity;
- Furniture that facilitates work with such features as ergonomic controls;
- Day care and/or other on-site amenities the unspoken statement is that the company values its employees.

Why is it so hard to hire good people?

If competing companies trying to attract employees in a tight job market offer essentially equal job responsibilities, wages, and benefits, the workplace environment begins to play a more important role in recruiting and retaining employees. In the case of

knowledge workers issues of aesthetics, visual and acoustical privacy, technology integration, ergonomics, meeting their personal needs, and especially support of work processes, are becoming increasingly important to attract them to work.

Just as companies are striving to meet the needs of new consumers, new markets and new competitors, they must also strive to meet the needs of the new worker.

Young people tend to look at "performance indicators" in a new company such as company reputation, their resulting social status and image, how it will look on their resume, and the skills they will acquire. The designed environment is part of the technological infrastructure to them. Based on their consumer buying habits and social expectations, young people expect superior furniture and technologies in the workplace. Older people have lower expectations because they often had fewer choices than younger generations.

Young people tend to view the designed workplace from two different attitudes depending upon their own needs and goals: instrumental and evocative. Those who view it instrumentally consider it as part of the technology, giving them the tools to get their work done, helping them to achieve recognition and advancement. Those who evaluate it evocatively tend to see it for its emotional character, liking to work in the space, seeing it more as background for work activities. Understanding these motivational profiles can help employers understand how young people evaluate their workplace. (Ron Goodrich, psychologist, *Workplace Change Enablers* (WCE))

For any kind of organisation to run successfully, several human elements are essential. One is good leadership at the top and, for best results, throughout the organisation. A second need is for good management. Third, there must be teams of people with the knowledge, skills, aptitudes and attitudes to perform at a sufficiently high level of production to accomplish the organisation's mission.

"The same requirements exist whether you are running a manufacturing company, a service business, a professional firm, a non-profit organisation an educational institution, a social service agency, a volunteer group or any other kind of entity. The need

is universal," says Rogers Herman, author of *Keeping Good People*.'

The workplace should be viewed as an investment in productivity enhancement that supports the organisation's strategic direction and that rightfully belongs on the balance sheet as opposed to simply an expense that shows up on the P&L. Companies need to think of competing for employees the same as they do about competing for market share.³

Although the correlation of a quality working environment with employee effectiveness is largely subjective and anecdotal, ever since the Hawthorne Studies of the late 1920s, progressive managers have understood that the workplace impacts productivity and organisational effectiveness.

The Hawthorne studies concluded that organisations are social systems whose output depends on both physical conditions and social conditions. Behaviour on the job depends on: attitudes, communications processes, and motivation.

The conclusions drawn in the Hawthorne Studies are perhaps even more applicable today with the advent of the knowledge worker who spends his or her time shuttling between working on one's own and being part of a team.

Francis Duffy, in his book *The New Office*, provides an invaluable source of inspiration and guidance on the integration of office design with elements of business management and organisational theory. It's Duffy's opinion that, "Forward-looking managers who want to drive their businesses as hard as possible to survive and succeed must relate the use of their office space to their overall business objectives. In other words, managers must treat office space not as something special or remote, but in exactly the same business-like way as every other managed resource."⁴

The role of furniture in attracting and retaining "the best and the brightest" can be in the positioning of the workplace during the recruitment process as well as in educating the existing workforce of the value of the investment the company has made toward enabling them to work to their individual and highest potential. (Bill Krebs, facilities strategist and *designer WCE*)

A progressive corporate culture must exist in order to nurture these visionary, "forward-looking" managers. Webster's defines culture as "the ideas, customs, skills, arts, etc. of a given people in a given period". Corporate culture shapes and guides how people perform their work and serves as a framework for acceptable-and unacceptable-behaviour within the organisation.

The physical expression of corporate culture is the buildings, office design, configuration, and furniture in the workplace. In this competitive job market, corporate culture plays a key role in any attraction, retention and effectiveness strategy.

Unfortunately, workplace configuration and design

are often perceived as "invisible and intangible" and, therefore, are not a priority in many corporate cultures. However, this attitude can be changed by "presenting strong evidence that the employee's workplace means a great deal in terms of initial attraction to an organisation as well as to their remaining with the company."⁵

An excellent step in this direction is a new study from the American Society of Interior Designers (ASID) that shows the physical workplace can play an important role in decisions about accepting or leaving jobs. The factors involved are comfort, accessibility, privacy and flexibility. The independent research study was supported by Haworth, USG Interiors, and the Carpet and Rug Institute.

When asked specifically if the physical workplace would have an influence on their decision to accept a position, two out of five employees said it would. Half said the physical workplace would impact their decision to leave a position.

When it comes to accepting or leaving a position, employees least satisfied with their jobs and those likely to change jobs soon are much more likely to cite physical workplace as an important factor in their decisions. These results suggest an unsatisfactory physical workplace is one of the factors contributing to employee dissatisfaction - a critical issue to CEOs struggling to find and keep good employees.

Attracting employees

Although a great deal has been written in various articles and books on career development about making the decision to select a new job as "objectively" as possible, there are many subjective influences that an individual considers when changing employment.

One of those influences is the space in which an employee will work. According to the ASID study, 41% of respondents said the physical workplace influences whether they would take a new job. The quality of office design and furniture conveys whether a company values its workers.

The old adage, "you never get a second chance to make a good first impression" certainly applies in the employee's evaluation process of a new employer. Often before potential employees speak to anyone in person, they are forming an impression of their potential workplace from how they are greeted at the door to how the lobby looks to the workplace itself.

Many candidates form a mental picture of their future workspace and assess what their level of comfort will be as well as the convenience of the supplies and services they will need. Within moments of walking in the door, they make initial judgments about their compatibility with the workplace. It is not at all unusual for a job seeker to ask to see their potential work area to before making a job decision.

The interior of an organisation has a significant impact on employee perception. The quality and

adequacy of the interiors is directly related to the organisation's image. Image is everything. Interiors can be a wow factor that sets the organisation apart from competitors - for both the customer and the potential applicant. A well designed interior that reflects the values and principles of the organisation will go a long way in establishing a connection between employee and an organisation's culture. (Paul Barnette, *architect, WCE*)

As evidenced from the ASID study, workplace conditions can be the difference between an interested candidate and someone moving onto the next job offer.

Giving employees design and decor options can be an effective part of a company's package to attract them. Although the quality of the individual workspace is important, so is the overall feeling that the workspace communicates. Workplace quality that first impression can create a lasting impression for a potential employee, one that can be a pivotal factor in their decision making process.

The psychological principle known as just prior condition (JPC) is important when considering the enhancement of a workplace. The JPC principle relates to a person's expectations. For example, if a person's workplace is changed, it is expected that it will be at least equal to or better than their previous situation. When recruiting new employees, expectations regarding the quality of their new workplace may need to be satisfied. But expectations are relative. An employee may feel "my current private office has old furniture, but I'd rather have privacy than new open plan furniture. In terms of my prior condition, I'm worse off if I lose acoustical privacy, visual privacy and more space." (*Len Kruk, futurist, WCE*)

Employee retention

Once companies have recruited employees, they are then faced with the task of retaining them. Two of the primary reasons for employee turnover are job-related stress and lack of job satisfaction.⁶

The pace of work and the simultaneous rate of change is faster than ever before. Many workers feel under-appreciated, overworked and overstressed.⁷ Overwork is a growing problem as the %age of workers reporting they work a 50 hour week has doubled from 1995 to 1998. And the number of days lost due to stress has increased 36% in that same period of time. Job-related stress is on the rise: employees reporting job-related burnout rose from 39% to 53% in the last three years.

Designers and facilities managers know from experience that space design and the work environment can help dissipate work-oriented stress. Poor space design has the opposite effect. Companies that want to retain their employees and keep them productive are learning the value of investing in the type of workplace that reduces stress. For example, at

Nortel Networks' new facility, which was designed to encourage interaction and create a sense of community, surveys show that 50% of employees report increased job satisfaction.⁸

Four years ago, ad agency Chiat/Day was among the first to have "virtual officing". The idea behind the virtual office was that telecommuting would allow people to work anywhere, anytime, and that they would use the outgrown building only for teamwork. As it turned out, most staff members needed or wanted to work under the same roof. To combat employees' overwhelmingly negative response, today the offices are now a "Chiat town" of private and group work spaces and public "streets" and meeting places that provide for every kind of company activity. The virtual office "sounded good in theory, but ultimately violated human tenets," said Lee Clow, the company's chairman. "People need a sense of place and belonging." Chiat/Day is one of the new crops of progressive workplaces that are designed to reduce stress.

A key to combating stress is having time and space for "recovery" where an employee can reflect on the causes of the stress and develop coping mechanisms. From individual acoustical privacy to an onsite coffee bar, the concept of the "safe haven" is being recognised as not only a tool to combat stress but also to enhance employee retention.⁹

A safe haven that manifests the following "five Cs" can provide an oasis for recovery and rejuvenation.

The "five Cs" encompass:

Control: the worker has the freedom to make decisions about his/her workspace, selecting (within organisational guidelines, standards and budget) furniture that suits their specific needs and tastes.

Within the organisation's guidelines, a worker can design their own workspace to help create a sense of a safe haven. Choices can be made relative to types of chairs, furniture, and accessories.

Implicit in the "control" attribute is flexibility where an employee can make modifications that will allow them to personalise their workspace so they can work efficiently with tools and equipment where they want and need them. This promotes individuality and creates variety in the workplace that helps make an employee feel wanted and special. The experts caution that a "one size fits all approach" undermines an employee's sense of control and negatively impacts their performance.¹⁰

Comfort: the worker can make their safe haven comfortable so that when recovery or concentration time is needed, they can feel relaxed in their workspace. Relaxation is an important part of one's work day as effective workers "oscillate" between periods of high and low stress which enables them to recover, enhancing their personal productivity and ability to address other work challenges." Ergonomic

seating and work stations that reduce noise afford a sense of comfort and enhance the ability to "close out the outside world."

Many people fail to realise the relationship between the functional comfort required to be effective and the furniture elements. The realisation that it is necessary to have seating that accommodates the broad variety of physical dimensions of workers has finally migrated from eight way adjustable car seats to office furniture. However there are still more adjustable steering wheels than adjustable work surfaces. (Bill Krebs, facilities strategist and designer WCE)

Convenience: the more amenities that are available, the more likely the worker is to stay in the workplace. That's why there is a national trend for larger companies to provide in-house childcare, take home food service, dry cleaners, etc.

Interiors are being designed to reflect mood, establish image, provide flexibility, support teaming and embrace "main street" types of activities. Some companies like Bristol Meyers in Princeton, New Jersey offer a main street-a small village shopping center featuring food services, bakery, credit union, shoe shine stand, hair dresser and a company store. (Len Kruk, WCE)

A caveat: Amenities can help attract quality workers, but first review cost effectiveness and employee preferences. How many employees will use the amenities? Are the amenities a good match for employee needs? An employee survey helps. Some amenities are better outsourced. For example, a childcare centre requires costly construction, insurance, and labour costs. It's best to compare an in-house operation versus outsourcing or stipends for parents.

"Although the government has been downsized and rightsized, it has also has to retain and attract the best and brightest. And the government is not necessarily competitive in terms of salary and benefits," says Ed Feiner, chief architect for the General Services Administration (GSA). Feiner says the GSA is currently evaluating the impact of innovations completed at six prototype sites nationwide at which they have implemented new standards for government facilities such as systems furniture, office landscaping, childcare centres, and expandable conference spaces.

Organisations such as John Hancock have been a pioneer in this area and attribute improved productivity to the provision of amenities.¹² These types of amenities often preclude the employee having to leave the workplace to run errands, increasing their time on the job. In addition, the convenience of printers, fax machines and high-need printing supplies enables workers to be more productive. Companies are learning what their staff members need to get the job done and still have a life outside the office.

Compatibility: there are several manifestations of

compatibility. First of all, the workplace must be compatible with the organisation's values as well as the values of the individual worker.

The quality of a workplace reveals how an organisation feels about its people and the subsequent impact on the individual worker should not be underestimated. Typically organisations have no effective way to measure this compatibility, although turnover is a primary indicator.

Even with today's workers being more likely to shift from job to job throughout their career, they are also more concerned about compatibility of values than those in previous generations. This observation is reinforced by the number of organisations that have clearly stated core values to guide and shape how work is performed. In the seminal business book of the 90s, *Built To Last*, the authors' research found that for companies such as Johnson Johnson and Merck who have enjoyed success for more than a century, a strong core ideology with representative core values was a source of their ongoing growth and success.

In addition, the workspace must be compatible with the work being performed. For instance, if much of the work is done by teams, sufficient team space must be available where teams can perform their work without interruption or interference. If much of the work is done individually, private, quiet workspace must be available for individual workers. Some workers need a flexible schedule or the option of working from home to be effective, so an appropriate workplace must be created at home.

Communications: the provision of equipment and a worker-focused workspace must be supported by ongoing communications and training on how to optimise these resources. Too often the fast pace of organisational life precludes sufficient training due to the lack of time.

Organisations have found that training facilities are an important retention tool because employees today are constantly seeking opportunities for professional and personal growth. The new employee compact is based on career fluidity and not "employment for life" so workers are continually seeking new learning opportunities." In addition, ongoing employee training and growth will have a positive impact on productivity and profitability.

Another aspect of communications is information sharing, the lifeblood of today's organisations. The availability of open space promotes informal information sharing and the growth of worker knowledge.

Steve Newport, director of human resources for Digital Resources in Toronto thinks space where employees can gather is invaluable to them and the organisation. "In most organisations, 80% of organisational learning happens through informal conversation and 20% through formal training. Here

you can chat with people easily because there are no office doors .1114 Inadequate information is the cause of more than half of the problems related to human performance so the individual and common workspaces must be hubs of information.¹⁵

Improving efficiency, effectiveness and productivity

The concept of the safe haven for the individual employee can be extrapolated to the "village haven," community workspace where employees can come together to share ideas or work in ad hoc teams or "hot groups."¹ The workplace should provide these types of spaces and employers need not be worried that these spaces will be abused for non-work related activities.

Dr. Abraham Maslow was a psychologist and behavioural scientist whose book "Motivation and Personality" presented concepts that were originally offered as general explanations of human behaviour but quickly became a significant contribution to workplace motivation theory. They are still used by managers today to understand employee motivation.

MASLOW S HIERARCHY OF NEEDS

Self-actualisation

Esteem

Love

Safety

Physiological

Dr. Maslow's research found that workers are first seeking to satisfy their basic physiological needs such as adequate food, air, water, shelter, rest and clothing, in essence, the things they need for their physical survival. These basic needs are affected by the employee's perception of the work environment.

Before employees' needs for esteem and self-actualisation become important to them, their safety and security needs and then their social needs need to be met. The workspace plays a significant role in these feelings. Progressive organisations manage their work environments and focus them on workers and their needs, receiving a dual payoff of retention and productivity.

As part of a cultural transformation, Owens Corning converted its corporate headquarters to open offices. Surveys showed that 60% of employees believe productivity improved and 80%

said the new environment helped them better focus on customer needs.

Companies using on-site amenities to lure and keep employees include 3Com Corporation, Anderson Consulting LLP, and Pitney Bowes, among many others. When Monster.com measured the impact of its new facilities, which were designed to combine hard work with a sense of play, 90% of employees surveyed said the new office improved the company's competitiveness as an employer.

By linking the purpose, values and objectives of the business with its people, employers can create a workplace that facilitates what the organisation and its people want to accomplish. By doing that, employers can give employees what they need to combat stress and work effectively a sense of control. This strategy will enable a company to attract motivate and retain talent that will ensure its ongoing growth and success.

Ten questions employers should ask about the impact of their company's work environment on attraction and retention of employees

1. Does your company treat the workplace as an investment or an expense? What is your office workplace strategy?
2. Do you know how your employees feel about their work space?
3. Have you considered adding amenities or office design choices as a recruiting incentive?
4. Do you feel your company relates the use of its office space to its overall business objectives?
5. Does your office design and furniture match your mental picture of what your vision of the company is or should be?
6. What first impression do you think job applicants have of your office? Have you ever asked them?
7. Do you think your employees are stressed? Do you ever ask them? Does the design of your work space cause stress or reduce stress?
8. Do your employees have a place at work where they can recover from stress?
9. Can your employees modify or personalise their workstations? Do they have the correct tools to be ergonomically comfortable, feel productive, and get the job done?
10. What message do your think your office sends to your employees? That you value them? That you want to facilitate them? That your office is the type of place where you would want to stay? Does your office space reflect your corporate culture?

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Valuation of rail corridors in New Zealand

Introduction

The valuation of transit or rail corridors in New Zealand remains largely an estimation based upon the historical use of the corridor and the summation of assets forming an intrinsic part of the corridor rather than the specific attributes of uninterrupted passage.

The relative paucity of transit or rail networks in New Zealand by comparison with other major developed countries further compounds the lack of documented research relating to the appraisal of these unique assets.

A number of international journals and articles have been studied relating to the appraisal of rail corridors and similar right of way uses although a number of these articles have a basis in sales comparison, an element distinctly missing from the New Zealand market. Similarly, a number of these international journals and articles present a relatively artificial or "stand alone" environment wherein the corridor is assessed.

A number of additional valuation considerations need to be weighted and separately identified over and above those of an exclusive use and freehold right of way.

Valuation methodology

The methodology involves a five stage process which comprises an assessment of the underlying land value within the corridor template having due regard to the restricted uses imposed by any occupancy agreement. The methodology for determining the underlying land value is the use of "at-the-fence" (ATF) value assessment. The ATF value is assessed with due regard to the existing or potential use of the land. Having concluded a land value further adjustment for the tenure in terms of any lease or occupancy agreement, being at a level below the freehold value, is required.

There is an added benefit for a continuous right of way corridor over and above the value of the individual allotments. The benefit or assemblage value relates to the uninterrupted nature of the right of way which acknowledges, in part, the difficulty of replicating the corridor at an alternative location, ie. resource consents, legal and professional fees, purchasing costs whether by negotiation or compensation. In addition, further consideration is

required relating to the non exclusive use of the corridor by the operator, lessee or licensee.

Railway corridors are unique properties and having due regard to the research and information available regarding the appraisal of their worth, our exercise is a common-sense approach formulated from international experience. Further explanation of the valuation considerations follows.

Valuation considerations

Underlying land value

In assessing an underlying land value, a weighted average land value approach can be assessed by applying the ATF land value weighted against the corridor area per square metre for the entire corridor. The land value apportionment reflects the worth of the underlying land in relation to the worth of the entire corridor. The justification for this approach is that it reflects the concept of deprival value, or the price that would be appropriate to replace the land. Arguments against this approach are related to the assumption that the land is currently in its unencumbered highest and best use. The methodology is based on the underlying assumption that the land under the corridor will neither increase or decrease over the length of the corridor but would retain a single uniform value per square metre weighted against ATF land values with due regard to the restrictive use.

The permitted use of the corridor land has a strong bearing on underlying land value. In this regard the underlying zoning may well be less restrictive than the use provided for in any occupancy agreement. The highest aggregate use throughout the corridor should be utilised.

To provide a more accurate basis for land value assessment the corridor may be sectionalised and an ATF value applied having due regard to the restrictive uses.

The assessed weighted average land value per square metre may then be applied to the area of the corridor to determine underlying land value having regard to any restrictive uses.

Adjustment for lease tenure/term

The methodology in determining the underlying land value assumes perpetual occupation of the land and requires adjustment for the terms and conditions of any occupancy agreements. To determine the

appropriate adjustment a discounted cashflow model may provide the most appropriate basis at land rental factors based upon comparable ground lease settlements. The cashflows require discounting at a rate reflecting the weighted risk which may be closely aligned to long term government stock.

Another factor to consider is the ability to raise mortgage finance against the lease, the terms and conditions of which would not be as favourable as if the ownership structure of the land was freehold.

Corridor assembly adjustment

Having accounted for the terms and conditions of any lease, it is appropriate to consider the additional benefit or added worth of an uninterrupted passage. International research including an analysis of rail corridor sales indicates that a premium factor of between 1.25 and 2.5 above ATF resulted in an average of approximately 1.50. These sale factors represent the exclusive use of a right of way or rail corridor into perpetuity. It is clear that a continuous uninterrupted right of way would be worth more than the sum of the individual allotments due to the increased utility. The question remains to quantify the level of assemblage value for such a corridor.

Corridor improvements and plant

Associated with the corridor area are other improvements and special civil works such as overbridges and tracks which would require separate consideration. Due to the relative dearth in exchange markets and value for the specific rail corridor assets and the high level of utility to the operator a value 'in-use' is the most appropriate basis upon which to proceed with their appraisal. The basic requirements of the corridor assets to fulfil a need and to have a continued functional utility acknowledged by the greater community is unquestioned.

Air rights

The added benefit of any air rights to either an operator or owner requires detailed consideration especially in proximity to populated areas. Greater examination is required of market demand for air rights and the ownership implications. Air rights may range from basic signage or the traversing of cables along any length of the corridor to pedestrian and vehicular overbridges in commercial centres. Quantifiably, the assessment of air rights over or around a corridor will depend upon a number of unique value drivers and may include but not limited to location, form of passage or use, corresponding ATF land values, volume (as compared to area), disruption and nuisance, assemblage and lease or occupancy terms and conditions.

Conclusion

Transit and rail corridors are unique assets that can add considerable value to any operating network if detailed consideration is given to the common-sense application of valuation methodology rather than a pure summation of the individual assets involved. The development of methodology to appraise the worth of these assets is well founded in international research although lacks the local content and the unique environment within which the New Zealand rail transit corridors form a part. Greater consideration needs to be given to differences in tenure, non exclusive use and the air rights associated with any asset traversing a range of land values and uses.

Lastly, it is to be kept in mind that the valuation methodology identified and undertaken is a product of a number of case studies involving the formulation and valuation of existing transit corridors in New Zealand.

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Young guns

here are key areas employers can focus on to get the most out of their graduate recruits. Most employers know graduates are an investment in their organisation's future. They understand they need to foster and develop graduates' enthusiasm into competence, skills and experience which can be harnessed and turned into tomorrow's leadership... and profit.

However like parenting, graduate development requires careful thought and accurate planning.

Once an employer has identified and successfully recruited their graduates, induction is the first real organisational challenge. From the start, new graduates need to have a sense of belonging to the organisation. Graduates need to be introduced to the organisation's key performance indicators and what effect their input can have on the organisation as a whole. Like any employee, it is imperative that graduate recruits feel their role is productive and valued.

Graduates need to understand the organisation's business literacy needs - how it makes money and how individual performance can add value to the bottom line. With this fundamental understanding, new graduates can begin to make a meaningful contribution much earlier than they might otherwise.

New employees' chances of success are also greatly improved if they have a framework and guidelines within which to operate. They should know what their responsibilities are, what is expected of them, and perhaps most importantly in the early days, what they should do when there is too much - or not enough - work to do. In order to maximise opportunities and minimise risk, it is essential that employers set clear boundaries. Client contact and the authority of the recruit need to be made clear to reduce the potential for misunderstanding.

Graduates are like sponges and stimulation is the key to growth. They have the capacity to soak up immense amounts of information. Getting graduates involved in different aspects of your organisation not only gives them a chance to understand the whole operation, but also tempts their tastebuds and may give them a better idea of

the areas they want to specialise in.

Having spent years preparing for working life, graduates are champing at the bit to face the challenge of real case management. Encouraging new recruits to attend client meetings, even in an observation capacity, allows them to gain the real life experience they need and want.

Another important factor in getting the most from graduates is the establishment of some type of mentoring process. Every person in the organisation should essentially be a mentor, but appointing a specific mentor will give the recruit an opportunity to probe the mind of someone they respect. The mentor need not be someone chosen by the employer. Often someone the graduate identifies with and who may share similar styles and areas of interest is the best choice.

At the end of the day it is the casual and informal interaction with experienced staff on which graduates thrive. Knowing that senior people in the organisation are prepared to spend time and take the interest in them is what really matters.

Challenging graduates is important for their development. Many employers don't appreciate how rapidly graduates can begin contributing. Graduates want to be pushed and challenged right from the start. Setting tasks slightly above their comfort level but with manageable risk is an important part of getting the most out of graduates.

Perceived business risk is often the biggest hurdle many employers struggle with in taking a "sink or swim" approach. This is often the best experience new recruits can get - and the only way to learn their boundaries.

Letting them take a few mouthfuls of water can be highly instructive as long as there is a lifeline handy and a wary eye for sharks. With management support, it should be possible for organisations to minimise risk while still giving graduates the important and satisfying opportunity to make decisions and swim successfully in the deep end.

Very few valuable resources are immediately useable in their raw states. Oil needs refining and gemstones require patience and skill to determine

which rocks hold great prizes within.

Like these resources and many others, graduates require the same attention, development and refinement - in short, you get out of graduates what you put in.

If you offer them a career rather than a job and are prepared to back it up with opportunities you will see a substantial return on your investment.

Bevan Gibbs is a *recent* graduate with the organisational *performance* consultancy *The Empower Group*.

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valuation for financial reporting

Introduction

This paper gives the background to the introduction of the new financial reporting standard FRS-3 *Accounting for Property, Plant and Equipment* and provides an overview of the requirements of the standard that are relevant to valuation.^{2, 3}

Development of the standard was completed by the Financial Reporting Standards Board (FRSB) of the Institute of Chartered Accountants of New Zealand (ICANZ) early this year and on March 2, 2001 it was approved by the Accounting Standards Review Board (ASRB), for the purposes of the Financial Reporting Act 1993 (the Act). The standard will apply to the general purpose financial reports of all reporting entities and groups, the Crown and all government departments, offices of Parliament, crown entities, and all local authorities. FRS-3 is effective for periods ending on or after March 31, 2002. However, consistent with S27(7) of the Act, entities may choose to adopt the requirements of FRS-3 at any time before its effective date.

FRS-3 results from the revision of existing accounting standards, SSAP-28: *Accounting for Fixed Assets* (SSAP-28) issued in July 1991, and SSAP-3: *Accounting for Depreciation* (SSAP-3) issued in October 1984. SSAP-28 applies only to property plant and equipment. However, SSAP-3 applies not only to property, plant and equipment but also to intangible assets. Thus, on completion of the transitional period for FRS-3, SSAP-28 will automatically lapse but SSAP-3 will continue to apply to intangible assets until a new financial reporting standard is issued on that topic.

Overview

The term "property, plant and equipment" in the title of FRS-3 replaces the term "fixed assets" which appeared in the title of SSAP-28. This change does not indicate a shift in scope. Rather, it picks up the title of the corresponding standard issued by the International Accounting Standards Committee (IASC) and it is more descriptive of the actual subset of "fixed assets" which are the subject of the standard. FRS-3 deals with all possible aspects of an entity's involvement with an item of property, plant and equipment over the period of holding the item. The standard covers

initial recognition, subsequent expenditure, revaluations, depreciation, impairment, disposal, and disclosure in financial reports.

As regards valuation, the major changes introduced by FRS-3 are as follows:

- A shift from existing use value to fair value as the base for revaluation of items of property, plant and equipment;
- The fair value of specialised assets is to be estimated by depreciated replacement cost but any land component must be included at fair value;
- Capitalised interest is to be included as part of depreciated replacement cost;
- Guidance on optimisation in the estimation of depreciated replacement cost;
- Where the components of an asset have different useful lives or provide benefits to the entity in different patterns, each component must be accounted for separately; and
- Revaluations are to be carried out with sufficient regularity to ensure that revalued assets are reported at amounts not materially different from fair value, and must be carried out at least every five years.

Consultation

In developing a new financial reporting standard, whether as a revision of an existing standard or on a topic not previously covered by a standard, the FRSB engages in extensive due process to ensure that all parties potentially affected by the standard have the opportunity to provide input into the development process and that, as a minimum, they become aware of the pending introduction of the new standard. A key part of this process is the development of an Exposure Draft (ED) of the new standard. The ED is published for interested parties to make comment. The comments received are reviewed and in the light of the results of that review and the outcome to any direct consultations with key parties affected by the proposals, a final form of the standard is then produced. The standard is then submitted to the ASRB for its consideration for approval for the purposes of the Act. The effect of approval is to give the standard the force of law for all entities falling within the scope of the standard.

FRS-3 is the final standard based on ED-82: *Accounting for Property, Plant and Equipment (ED-82)* and the subsequent Invitation to Comment: *Basis for Revaluation of Property, Plant and Equipment (IC)* which were issued for comment by the FRSB in 1998 and 1999 respectively

In addition to publication of the ED and IC, members of the FRSB and ICANZ standards staff consulted extensively with parties likely to be significantly affected by the new standard. In particular, ongoing liaison has been undertaken by the FRSB with the Valuation & Property Standards Board (V&PSB) of the New Zealand Property Institute (NZPI) regarding the proposed requirements on revaluations. The objective of the liaison has been to ensure that the financial reporting requirements on revaluation can be "operationalised" by members of the NZPI in undertaking valuations so that valuations are reliable, relevant and consistent. Having FRSB representation on the V&PSB has facilitated the liaison. Additionally, meetings of representatives of the FRSB and the V&PSB were held to discuss interest capitalisation in valuation and also particular aspects of the valuation of specialised assets.

Background

In preparing financial statements in New Zealand the normal practice is to apply historical cost. However, a good number of entities combine historical cost with the practice of revaluing certain items of property plant and equipment. This practice is known as "modified historical cost". In its *Statement of Concepts for General Purpose Financial Reporting*, the FRSB has expressed a preference for modified historical cost as it meets the objectives of financial reporting better than does historical cost. However, the provisions of FRS-3 on revaluation do not require entities to adopt modified historical cost; rather they specify the valuation requirements that must be followed if entities choose to adopt modified historical cost.

Where assets are revalued, SSAP-28 requires that existing use value be the basis for revaluation and ED-82 proposed that existing use value should continue to be the required revaluation basis. However, FRS-3 requires fair value as the basis for revaluation of assets. The shift from existing use value to fair value came about as follows. At the time of issue of ED-82, all the standards of other jurisdictions that specified a basis for revaluation required the existing use valuation base. Existing use value was (and still is) the base required under the corresponding UK standard, FRS 15: *Tangible Fixed Assets*, and it was the base required under the corresponding IASC standard, IAS 16: *Property, Plant and Equipment (IAS 16)*. At that time, the relevant Australian Accounting Standards Board (AASB) standards did not specify a required revaluation base. Consistency with the requirements

in other jurisdictions was a key factor in the FRSB's decision to propose that the SSAP-28 position be continued in ED-82.

The comments received by the FRSB on ED-82 displayed a fairly even division of views on whether revalued assets should be measured at existing use value or at fair value. However, consistent with the view of the FRSB, many responses indicated that harmonisation with the positions in relevant overseas standards should be an important factor in establishing a final position.

After the issue of ED-82, the positions in the relevant overseas standards changed. IAS 16 (revised), issued in 1998, and AASB 1041: *Revaluation of Non-Current Assets*, issued in 1999, both require fair value to be used as the basis for revaluation. In view of this change, the FRSB issued the IC in December 1999 seeking further constituent comment on the issue of the required basis for revaluation. After consideration of the comments received and further consultations with the V&PSB and also the electricity sector, the FRSB decided that fair value should be the required base for revaluation in FRS-3.

The valuation requirements

The requirements of FRS-3 are largely consistent with the requirements of the relevant IASC and AASB standards. FRS-3 most closely parallels IAS 16: *Property, Plant and Equipment*. There is no equivalent "stand-alone" AASB standard. The corresponding AASB requirements are fragmented over several standards and these are not limited to property, plant and equipment. The principal difference between FRS-3 and the IASC and AASB standards is in the scope of the standards - FRS-3 contains comprehensive guidance not provided in the overseas standards, principally as the result of FRS-3 being intended for application by both private sector and public sector entities.

The sections of FRS-3 directly relevant to valuation for financial reporting are reproduced in the Appendix to this paper. Below we comment on the key aspects of the requirements.

Shift to fair value

The FRS defines fair value as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction (para 4.23). Other terms commonly used to describe fair value include "market value", "open market value", and "current market value" (para 4.24). 'When fair value is unable to be reliably determined using market based evidence, depreciated replacement cost is considered to be the best estimator of fair value (para 4.26).

The impact of the change from existing use value to fair value arises from the difference in valuation approach between the two bases. In essence, existing use value is the value of the asset employed in its

existing use and it ignores any higher value alternative use potential. In contrast, fair value is the value of the asset when employed in its highest and best use. A critical distinction between the approaches is therefore whether the value of the asset is determined based on the actual use of the asset or based on the asset itself, independent of that actual use.

In principle, fair value is greater than existing use value by the value of any surplus capacity. However, under the fair value approach, the value of surplus capacity depends on such capacity itself having a market value. For assets where surplus capacity has arisen through historical accident and has no value to any possible new owner of the asset, such surplus capacity will not be attributed a value and hence fair value would equal existing use value.

In the case of specialised assets, where appropriate direct market evidence of selling price is unlikely to be available, the change from existing use value to fair value could have two particular impacts:

Optimised deprival value (ODV)

ODV has been used as a measure of existing use value by entities such as electricity lines companies. ODV is the lower of depreciated replacement cost and economic value. However, if under FRS-3, fair value is estimated by depreciated replacement cost then ODV cannot be used as a measure of fair value where economic value is lower than depreciated replacement cost. The shift to fair value may thus lead certain business entities to report fair value in general purpose financial reports but (a different) ODV in regulatory reports. However, the consultations with the electricity sector confirmed that there is unlikely to be any significant compliance cost associated with having two valuations undertaken. This follows because depreciated replacement cost must first be calculated in determining ODV, and in the case of these companies, fair value would be estimated by depreciated replacement cost (para 4.26).

Specialised properties

Under FRS-3, the depreciated replacement cost of specialised properties is the sum of the fair value of the land plus the current gross replacement cost of improvements less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity (para 4.10). Thus, in contrast to some valuation approaches used to meet the requirements of SSAP-28 which involved optimisation of the land component of property, FRS-3 requires that the land component must be included at fair value.

FRS-3 thus rules out optimisation of the value of the land, in terms of its size or location, even if such factors are under-utilised. For example, in a case where specialised manufacturing facilities are located in a prime central business district location but the operation would be able to be run from a smaller sized and less valuable alternative site offering the same

service potential, the fair value of the land would still be the open market value of the full size of the central business district-located site.

There are probably many examples in New Zealand of suboptimal use of prime location land. During the development of FRS-3, the FRSB became aware of examples of inconsistent approaches to determining the depreciated replacement cost of the land component of such properties. This concern was a further cause for the FRSB's decision to issue the IC subsequent to the issue of ED-82. The FRSB considers that its decision to adopt fair value in FRS-3 will lead to more reliable valuations of specialised properties. This belief is also held by the NZPI's V&PSB. The FRSB recognises that the decision may in some cases lead to less relevant information. However, the expectation is that the gain in reliability will outweigh the loss in relevance, if any

Mandatory capitalisation of interest

FRS-3 requires borrowing costs that are directly attributable to the acquisition or construction of an item of property, plant and equipment to be capitalised. SSAP-28 allows, but does not require, this treatment. The expected impact will be greater consistency in the components of cost between purchased assets (where attributable borrowing costs of the vendor will form part of the selling price of the asset) and self-constructed assets.

Valuation guidance

SSAP-28 does not provide any guidance on valuation. Instead, it just defers to the Asset Valuation Standards of the (then) New Zealand Institute of Valuers. FRS-3 provides extended guidance on the principles relevant to valuation for financial reporting purposes. Most of the guidance concerns determination of depreciated replacement cost and, in particular, which factors optimisation may be applied to. Part of this guidance clarifies that a notional amount for attributable capitalised interest must also be included as a component.

The inclusion of this guidance in FRS-3 (in conjunction with the change from existing use value to fair value) should ensure that greater consistency is achieved in the determination and estimation of fair value. The expected result is therefore that users will be able to place greater reliance on valuation information.

Components

FRS-3 requires items of property, plant and equipment to be recorded at a component level when the item comprises various components that have different useful lives or provide a different pattern of benefits to the entity. This requirement applies to all assets but is particularly relevant to infrastructure assets. SSAP-28 does not include this requirement and, as a result, some entities holding infrastructure assets adopted renewals accounting approaches. FRS-3 requires the use of traditional fixed asset accounting.

Adoption of the components approach will have valuation and reporting implications for valuers.

Compliance costs

FRS-3 makes two other changes in revaluation requirements from the position in SSAP-28:

- FRS-3 requires revaluations to be undertaken at least every five years whereas SSAP-28 requires revaluations to be undertaken at least every three years; however, FRS-3 states the principle for determination of the frequency of revaluations as being that revaluations must be carried out with sufficient regularity to ensure that the carrying amount of a revalued asset is not materially different from its fair value. Thus, under certain market conditions, revaluations may be required to take place more frequently under FRS-3 than has been the common practice under SSAP-28; and
- FRS-3 permits an exemption from the requirement to have valuations of plant and equipment undertaken by independent valuers where there is an active market or readily available price indices that establish the item's fair value with reasonable reliability. SSAP-28 does not permit such an exemption.

These changes might appear to indicate a reduced involvement for valuers in valuation for financial reporting purposes. However, the FRSB's motivation in making these changes was to encourage more entities to switch to modified historical cost. With the possible reduction in associated compliance costs, entities currently using the historical cost measurement model may move to the modified historical cost model. Thus the changes are consistent with the FRSB's position of preference for modified historical cost and, if the intended consequence is achieved, valuers will end up with greater involvement in valuation for financial reporting purposes.

Transitional provisions

FRS-3 includes generous transitional provisions, which are as follows:

- A two year deferral of the application of the subsequent expenditure, depreciation, and impairment requirements of FRS-3 is given to entities that do not currently comply with those requirements; and
- A five year deferral of the application of the asset revaluation reserve accounting requirements is given to entities that do not currently comply with those requirements in respect of accounting at the component level.

These provisions have been introduced primarily to give entities holding infrastructure assets, sufficient time to install appropriate systems to enable them to properly comply with FRS-3.

The next step

The task now facing the NZPI is to revise Valuation Standard 3: Valuations for Financial Statements

to accommodate the new requirements. The V&PSB has developed a plan which targets the issue of the revised standard as taking place by the end of this year. This timing is critical to members being adequately prepared for conducting valuations for entities with March 2002 balance dates. The key tasks are preparation of a draft of the revised standard, consultation with members and other relevant parties, and preparation of the final standard. It is envisaged that the consultations will include "road-show" presentations in the main centres during July/August of this year.

In developing the draft of the new valuation standard, the V&PSB will continue to liaise with the national asset management steering group Within local government, which is developing a Guideline on aspects of the valuation of infrastructure assets. It is anticipated that the Guideline will be issued mid to late 2001.

Appendix

Excerpts from FRS-3 *Accounting for Property, Plant and Equipment* directly relevant to valuation for financial reporting purposes.

4 Definitions

Standard

4.1 "Borrowing costs" are interest and other costs incurred by an entity in connection with the borrowing of funds.

Commentary

4.2 Borrowing costs include:

- (a) interest on bank overdrafts, short- and long-term borrowings;
- (b) amortisation of discounts and premiums relating to borrowings;
- (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
- (d) the cost of hedging contracts entered into, including the forward point differential at inception of the hedging arrangement.

4.3 Borrowing costs do not include exchange differences arising on foreign currency borrowings except as provided in paragraph 4.2(d) of this Standard.

Standard

4.4 "Capitalisation" is the process of including incurred costs in the carrying amount of an asset. "Capitalised" has a corresponding meaning.

Standard

4.7 "Class" is a category of assets or liabilities that have a similar nature or function in the operations of the entity.

Commentary

4.8 Examples of a class of items of property, plant and equipment may include all of an entity's plant (i.e. items of a similar nature), or all of the components of a

sewerage system (i.e. items of a similar function).

4.10 "Depreciated replacement cost" is a method of valuation that is based on an estimate of:

(a) in the case of property:

(i) the fair value of land; plus

(ii) the current gross replacement costs of improvements less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity;

(b) in the case of plant and equipment, the current gross replacement cost less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity.

Commentary

4.11 Fair value is defined in paragraph 4.23 of this Standard. Depreciated replacement cost is an acceptable estimate of the fair value of an asset only where the fair value of the asset is not able to be reliably determined using market-based evidence. In the case of property, market-based evidence might exist concerning either the land component or the property in aggregate. Depreciated replacement cost is used as an estimate of the fair value of property only where the fair value of the property in aggregate cannot be reliably determined using market-based evidence.

4.12 In the context of this Standard, depreciated replacement cost is based on the reproduction cost of a specific asset. In principle, it reflects the service potential embodied in the asset. However, in some cases, the reproduction cost of the specific asset is adjusted for optimisation in determining depreciated replacement cost.

4.13 Optimisation refers to the process by which a least cost replacement option is determined for the remaining service potential of an asset. This process recognises that an asset may be technically obsolescent or over-engineered, or the asset may have greater capacity than that required. Hence optimisation minimises, rather than maximises, a resulting valuation where alternative lower cost replacement options are available. In determining depreciated replacement cost, optimisation is applied for obsolescence and relevant surplus capacity.

4.14 Obsolescence may arise from factors such as outmoded design and functionality of an asset and changed code requirements preventing reconstruction of an asset in its current form. In determining depreciated replacement cost, optimisation for obsolescence is made by reducing the reproduction cost of the specific asset held to the cost of a modern equivalent asset that provides equivalent service potential to that of the specific asset held.

4.15 Surplus capacity may arise from either over-design or from surplus components of an asset. In determining depreciated replacement cost, optimisation is applied only to surplus capacity that is not required currently and for which there is no

reasonable prospect it will ever be required in utilising an asset in its current form. Optimisation is not applied to surplus capacity that, while rarely or never used, is necessary for stand-by or for safety purposes.

4.16 In determining depreciated replacement cost, the extent of any reduction in value for surplus capacity subject to optimisation depends on whether that surplus capacity has an alternative use to the current use of the asset. Where there is no alternative use, the optimised value of the surplus capacity is zero. Where there is an alternative use, the optimised value of the surplus capacity is the value of the highest and best alternative use of that capacity.

4.17 To illustrate the distinction described in paragraph 4.16 between surplus capacity not having an alternative use to the current use of the asset and that which does, consider the following example. Assume depreciated replacement cost is to be determined for a network of water pipes where the pipe diameter is greater than currently required or ever expected to be required (including that necessary for stand-by or for safety purposes). There is also a discrete segment of the piping network that is similarly not required for the current use of the asset but which can be closed off and used for other purposes, such as a liquid storage facility. In this case, the surplus diameter of the piping would be disregarded for valuation purposes but the surplus segment of the piping network would be valued at its highest and best alternative use.

4.18 In most cases, surplus capacity subject to optimisation is expected to be disregarded in determining the depreciated replacement cost of an asset. Such surplus capacity is unlikely to have an alternative use unless it is physically and operationally separable from the required capacity.

4.19 In determining depreciated replacement cost, optimisation for obsolescence and relevant surplus capacity is applied only to the extent that it reflects the most probable use of the asset that is physically possible, appropriately justified, legally permissible and financially feasible.

4.20 As evident from the definition of depreciated replacement cost, optimisation is applied only in determining the depreciated replacement cost of plant and equipment and in determining an estimate of the value of the improvements component of the depreciated replacement cost of property. Optimisation is not applied in determining the value of the land component of the depreciated replacement cost of property. The value of the land component will always reflect the fair value of the actual land held, in terms of both its size and location, even if such factors are underutilised. For example, in a case where specialised manufacturing facilities are located in a prime central business district site but the operation would be able to be run from a smaller sized and less valuable alternative site offering the same service potential, the

fair value of the land would be the open market value of the full size of the central business district-located site.

4.21 An amount equal to the amount of borrowing costs that would be embodied in the fair value of the asset is included as a component of depreciated replacement cost. The inclusion of such an amount as a component of depreciated replacement cost is consistent with the principle underlying the inclusion in the initial cost of an asset of borrowing costs eligible for capitalisation in accordance with section 5 of this Standard. The amount to be included as a component of depreciated replacement cost is determined on the basis of the average debt to equity ratio and average cost of debt applicable to entities within the same industry as the entity reporting.

Standard

4.23 "Fair value" is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Commentary

4.24 Other terms commonly used to describe fair value include "market value", "open market value" and "current market value".

4.25 The fair value of an asset is the exchange amount, as described in paragraph 4.23, at the operative date. The fair value of an asset is determined by reference to its highest and best use, that is, the most probable use of the asset that is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value.

4.26 Where the fair value of an asset is able to be determined by reference to the price in an active market for the same asset or a similar asset, the fair value of the asset is determined using this information. Where the fair value of an asset is not able to be determined in this manner, the fair value of the asset is determined using other market-based evidence, such as by a discounted cash flow calculation using market estimates of the cash flows able to be generated by the asset and a market-based discount rate. Where fair value of the asset is not able to be reliably determined using market-based evidence, depreciated replacement cost is considered to be the most appropriate basis for determination of fair value. This situation will usually only arise where an asset is specialised or the only transaction price evidence arises in a monopoly context.

4.27 Most items of property, plant and equipment are able to be sold in their own right, and market-based evidence of fair value for these items will often be readily available. Examples of such items include motor vehicles, shops, office blocks, industrial complexes, churches, police stations and post offices.

4.33 "Net market value" is the fair value at a particular date less the costs of disposal that could

reasonably be anticipated at that date.

Commentary

4.34 In determining net market value it is not appropriate for the costs of disposal to be discounted because they will already be expressed as a current value. Other terms commonly used to describe net market value are "net current value" and "net realisable value".

Standard

4.35 "Property, plant and equipment" are tangible assets that:

- (a) are held by an entity for use in the production or supply of goods and services, for rental to others or for administrative purposes, and may include items held for the maintenance or repair of such assets; and
- (b) have been acquired or constructed with the intention of being used on a continuing basis.

Commentary

4.36 SSAP-17: Accounting for Investment Properties and Properties Intended for Sale includes within the definition of investment properties, property held primarily for rental. Confusion could therefore arise as to whether property held by an entity for rental to others is to be accounted for in accordance with this Standard, or in accordance with SSAP-17. Professional judgement is required to determine which Standard is more appropriate. The following property will generally be accounted for in accordance with this Standard:

- (a) property held for short-term rental where the entity is actively managing that property;
- (h) property whose rental is directly linked to the risks and rewards of the business being operated from that property.

Other property, including property held primarily for capital growth, is to be accounted for in accordance with SSAP-17. Thus hotels are normally accounted for in accordance with this Standard, whereas shopping centres and office blocks are normally accounted for in accordance with SSAP-17.

4.37 Some items of property, plant and equipment are commonly described as "infrastructure assets". Infrastructure assets meet the definition of property, plant and equipment and are to be accounted for in accordance with this Standard. Infrastructure assets usually show some or all of the following characteristics:

- (a) they are part of a system or network that could not operate if one component were removed;
- (b) they comprise large numbers of components having different useful lives or providing benefits in different patterns;
- (c) they enable the provision of essential services, seen as necessary to sustain living standards;
- (d) they are specialised in nature and do not have alternative uses;
- (e) they are immovable;

(f) they are subject to constraints on disposal. These characteristics are not confined to infrastructure assets, nor are infrastructure assets confined to the public sector.

4.38 Some resources are described as "heritage assets" because of their cultural or historical significance. Heritage assets that meet the definition of property, plant and equipment are to be accounted for in accordance with this Standard.

4.39 Determining whether an item of property, plant and equipment that incorporates both intangible and tangible components should be accounted for in accordance with this Standard requires judgement to assess which component is more significant. For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment; the same applies to the operating system of a computer. Even though an asset may not meet the definition of property, plant and equipment because its tangible component is not the more significant component, an application of the principles contained in this Standard may nonetheless be appropriate.

Standard

4.44 "Revaluation" means recognition in the financial statements of an upwards or downwards valuation of an asset at a particular date subsequent to its acquisition or construction.

Standard

4.54 "Value-in-use" is the present value of the net future cash flows obtainable from an asset's continuing use and ultimate disposal.

Commentary

4.55 Estimating the value-in-use of an item of property, plant and equipment involves:

- (a) estimating the future cash inflows and outflows to be derived from continuing use of the item and from its ultimate disposal;
- (b) determining an appropriate discount rate.

Financial reporting

5 Initial recording of property, plant and equipment

Allocation of cost to individual items of property, plant and equipment

Standard

5.15 When a collection of items of property, plant and equipment is acquired, other than in an acquisition in terms of the Financial Reporting Standard dealing with accounting for acquisitions resulting in combinations of entities or operations, the cost must be allocated to individual items in proportion to their fair values at the time of acquisition.

Commentary

5.16 Judgment is required in determining what constitutes a separate item of property, plant and

equipment. It may be appropriate to aggregate individually immaterial items such as moulds, tools, and dies.

5.17 Land and buildings are separable items of property and are usually accounted for separately, even when they are acquired together.

Allocation of cost to components of an item of property, plant and equipment
Standard

5.18 When the components of an item of property, plant and equipment have different useful lives or provide benefits to the entity in different patterns, thus requiring different depreciation rates and methods, the cost of the item must be allocated to its components and each component must be accounted for separately.

Commentary

5.19 In certain circumstances it is necessary to allocate the cost of an item of property, plant and equipment to its components and account for each component separately. This is the case when the components have different useful lives or provide benefits to the entity in different patterns, thus requiring different depreciation rates and methods. The level at which components are accounted for separately is therefore the level at which the expected timing of their replacement varies from other components that form part of the same item of property, plant and equipment. For example:

- (a) an aircraft and its engines need to be treated as separate items if they have different useful lives;
- (b) the land, pavements, formation, kerbs and channels, footpaths, bridges, and lighting need to be treated as separate items within a road system to the extent that they have different useful lives.

5.20 When the components of an item of property, plant and equipment are accounted for separately, decisions in relation to depreciation and subsequent expenditure can be made for each component. If the components are not accounted for separately, it can be difficult to make informed decisions about how an item should be depreciated or whether subsequent expenditure may be capitalised.

5.21 Judgement will be required to decide which components of complex items of property, plant and equipment are accounted for separately. Components will not need to be accounted for separately if materially the same total depreciation expense, carrying amounts and revaluation movements will otherwise result. For entities with asset management plans, it is expected that items of property, plant and equipment will be accounted for at a higher aggregation level (i.e. at a lesser level of detail) than that recorded in the asset management plans.

Borrowing costs

Standard

5.24 Borrowing costs that are directly attributable to the acquisition or construction of an item of

property, plant and equipment must be capitalised.
5.25 The amount of borrowing costs capitalised during a period must not exceed the amount of borrowing costs incurred during that period.

Commentary

5.26 Borrowing costs that are directly attributable to the acquisition or construction of an item of property, plant and equipment are those borrowing costs that would have been avoided if the expenditure on the item had not been made.

5.27 When an entity borrows funds specifically for the purpose of obtaining an item of property, plant and equipment, the amount of borrowing costs capitalised is the actual borrowing costs incurred on those borrowings during the period. However, if the borrowed funds are invested temporarily, the amount of the borrowing costs capitalised is limited to the cost of borrowings that funded actual expenditure during the period.

5.28 To the extent that funds are borrowed for general purposes and used to obtain an item of property, plant and equipment, the amount of borrowing costs capitalised is determined by applying a capitalisation rate to the expenditures on that item. Normally the capitalisation rate would be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining other assets.

5.29 Borrowing costs incurred by a member of a group can be capitalised in the group financial report only to the extent of external borrowings by the group.

Commencement of capitalisation

Standard

5.30 Capitalisation must commence:

- (a) when activities that are necessary to bring the item to working condition for its intended use are in progress; and
- (b) when expenditures directly attributable to the item are being incurred; and
- (c) in relation to the capitalisation of borrowing costs, when borrowing costs are being incurred.

Commentary

5.31 Activities that bring an item of property, plant and equipment to working condition for its intended use encompass more than the physical construction of the item. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits. However, they do not include the work involved in evaluating a number of proposals prior to deciding the nature of the item to be constructed, or similar preliminary activities.

5.32 Activities that bring an item of property, plant and equipment to working condition for its intended use must be in progress before any costs can be capitalised. For example, even if property rates are being incurred, they are to be expensed in the period if

no associated development of the item of property, plant and equipment is taking place.

Suspension of capitalisation

Standard

5.33 Capitalisation must be suspended if active development of an item of property, plant and equipment is interrupted.

Commentary

5.34 Costs may still be incurred during an interruption of the activities undertaken to bring an item of property, plant and equipment to working condition for its intended use. Such costs relate to holding a partially completed item of property, plant and equipment and do not qualify for capitalisation to the cost of the item. However, the capitalisation of costs is not normally suspended during a period when substantial technical or administrative work is being carried out. The capitalisation of costs is also not suspended when a temporary delay is a necessary part of the process of bringing the item of property, plant and equipment to working condition for its intended use. For example, the capitalisation of borrowing costs may continue while high water levels delay construction of a bridge if such high water levels are common during the construction period in the geographic region involved.

Cessation of capitalisation

Standard

5.35 Capitalisation must cease when substantially all the activities necessary to bring an item of property, plant and equipment to working condition for its intended use are complete.

5.36 The construction of an item of property, plant and equipment is sometimes completed in parts, with each part capable of being used while construction continues on other parts.

Capitalisation in relation to that usable part must cease when substantially all the activities necessary to prepare that part for its intended use are complete.

Commentary

5.37 A business complex comprising several buildings, each of which can be used individually, is an example of an item of property, plant and equipment where each part is capable of being used while construction continues on other parts. An example of an item of property, plant and equipment that needs to be complete before any part can be used is an industrial plant involving several integrated processes that are carried out in sequence at different parts of the plant within the same site, such as a meat works.

7 Revaluations

Standard

7.1 Subsequent to initial recognition, an item of property, plant and equipment may be revalued provided that:

- (a) all the items within the class of property, plant

and equipment to which the item belongs are revalued to fair value;

(b) subject to paragraph 7.20, revaluations are undertaken on a systematic basis:

(i) with sufficient regularity to ensure that no individual item of property, plant and equipment within a class is included at a valuation that is materially different from its fair value; and

(ii) at a minimum, every five years;

(c) subject to subparagraph (d), the valuation is conducted either:

(i) by an independent valuer; or

(ii) where an entity has in its employ a person sufficiently experienced to conduct a valuation, by that person, so long as the basis of valuation has been subject to review by an independent valuer;

(d) for plant and equipment, where there is an active market or readily available price indices that establish the item's fair value with reasonable reliability, the valuation need not be conducted or reviewed by an independent valuer or experienced employee.

Commentary

7.2 While the annual revaluation of items of property, plant and equipment is not required by this Standard, the adoption of a system involving annual revaluation, especially of land and buildings, is encouraged in order to provide more relevant information to users of an entity's financial report.

7.3 When an item of property, plant and equipment is revalued, the use of fair value is considered to be the most appropriate basis of valuation because it represents the exchange value of the future economic benefits embodied in the asset regardless of the manner in which the entity has chosen to utilise the asset.

7.4 Disposal costs are not deducted in determining the value of an item of property, plant and equipment unless there is an intention to dispose of the item.

Items of property, plant and equipment that are intended for sale are dealt with in paragraph 10.10 of this Standard.

7.5 The required frequency of revaluation depends upon movements in the fair value of the items of property, plant and equipment being revalued. When the fair value of a revalued item differs materially from its carrying amount, a further revaluation is necessary. Some items may experience significant and volatile movements in fair value thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items with only insignificant movements in fair value. However, where circumstances arise that are similar to those listed in paragraph 9.4 of this Standard, it will normally be appropriate that the carrying amount of an item be reviewed to assess whether there is any indication that

it is likely to differ materially from its fair value. If such an indication exists, the entity should revalue the item. Regular revaluations at intervals of no more than three years are preferable to ensure that the carrying amount of an item remains relevant. However, in every case, at a minimum, an item is to be revalued every five years.

7.6 For the purposes of paragraph 7.1(c), independent valuers are to hold a relevant professional qualification and have experience in the location and category of property, plant and equipment being valued.

7.7 For the purposes of paragraph 7.1(c)(ii), employees sufficiently experienced to conduct valuations are those who possess expert knowledge and experience in the location and category of property, plant and equipment being valued. The basis, methodology and assumptions underpinning valuations conducted by such experienced employees are to be reviewed by independent valuers to ensure the appropriateness of the valuation approach.

7.8 To the extent that the relevant standards and guidance are consistent with principles for determination of fair value set out in section 4 of this Standard, an independent valuation or review by an independent valuer is to be carried out in accordance with standards and guidance comparable to the valuation pronouncements issued, or officially endorsed, by the New Zealand Property Institute.

7.9 For the purposes of paragraph 7.1(d) of this Standard, a valuation may be undertaken without the need for an independent valuer or experienced employee only where there is sufficient objective market information available which enables two or more non-experts to determine materially the same fair values of the particular item of property, plant and equipment. Paragraph 7.1(d) is not applicable where depreciated replacement cost is the most appropriate basis for determination of the fair value of an item of property, plant and equipment.

7.10 A valuation carried out for purposes other than financial reporting, for example a rating valuation, is not to be used as the basis for recording a revaluation unless the basis of valuation has been confirmed as appropriate, in accordance with the requirements of this Standard, by an independent valuer.

9 Impairment

9.4 Subject to paragraph 9.1, the following indications, as a minimum, must be considered in assessing whether there is any indication that an item of property, plant and equipment may be impaired:

External sources of information

- (a) during the period, the item's fair value has declined significantly more than would be expected as a result of the passage of time or normal use;
- (b) significant changes with an adverse effect on the entity have taken place during the period, or

will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an item is dedicated;

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an item's value in use and decrease the item's recoverable amount materially;

(d) the carrying amount of the net assets of the entity is more than its market capitalisation;

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an item;

(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an item is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an item belongs or to dispose of an item before the previously expected date; and

(g) evidence is available from internal reporting that indicates that the economic performance of an item is, or will be, worse than expected.

Commentary

9.5 The list of indications of impairment in paragraph 9.4 is not exhaustive. Other indications that an item of property, plant and equipment may be impaired may exist and these would also require the entity to determine the item's recoverable amount.

9.6 Evidence from internal reporting that indicates that an item of property, plant and equipment may be

impaired includes the existence of:

(a) cash flows for acquiring the item, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;

(b) actual net cash flows or operating surplus or deficit flowing from the item that are significantly worse than those budgeted;

(c) a significant decline in budgeted net cash flows or operating surplus, or a significant increase in budgeted deficit, flowing from the item; or

(d) operating deficits or net cash outflows for the item, when current period figures are aggregated with budgeted figures for the future.

1 Kevin Simpkins is Assistant *Auditor General* (Accounting and Auditing Policy) and a member of the ICANZ *Financial Reporting Standards Board*; Tony van Zijl is *Professor of Accounting & Financial Management* at Victoria University and a member of both the *Accounting Standards Review Board* and the *NZPI Valuation & Property Standards Board*; Mark Westwood is the ICANZ *Director Accounting Standards* and is also a member of the *NZPI Valuation & Property Standards Board*.

2 This paper is drawn from a paper by the present authors that covers the financial reporting requirements as well as the valuation requirements of the new standard.

That paper, and a further paper by the authors, that compares the requirements of the new standard with relevant overseas standards, appear in the May and June 2001 issues respectively of the *Chartered Accountants Journal of New Zealand*.

3 The authors gratefully acknowledge the helpful comments of Richard Chung, John Dunckley and Gary Sellars.

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Valuing Winstone Pulp's Karioi forest

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Additional award of sole arbitrator

Winstone Pulp International Limited (WPI) and Her Majesty the Queen ("Crown") are the parties to a Crown Forest Licence ("CFL") dated 30 November 1990. In terms of that licence the annual rent was subject to review as at November 20, 1996.

As the parties were unable to agree on land value, I was appointed as sole arbitrator and delivered my award on February 4, 1999. After consideration of the evidence I determined a land value as at November 30, 1996 of \$8,100,000.

WPI appealed my decision on the basis that I had made errors of law in my award. The appellants asserted that:

- The principles established under the Valuation of Land Act 1951 to assess the value of "land and land value" were not relevant to an assessment of those same factors under the Crown Forest licences; and
- That the Arbitrator erred in not taking into account the pre-plant costs and fertility difference in valuing the land at Karioi.

In a High Court decision dated April 27, 2000 Robertson, J determined there was no error in law on the first issue. However, on the second issue he stated: "I am satisfied that the Umpire by valuing the land as if it were pastoral land to be used for forestry purposes made an error of law. Under the terms of the Licence he was to value the land as it actually was. Depending on the factual situation this may or may not require an adjustment to be made for pre-plant costs, when using the put and take method.

As he made no findings as to what adjustment, if any, should be made the issue must be remitted back to the Arbitrator for his decision on that point."

At a rehearing on August 27, 2000 I received submissions in respect of the pre-plant cost issue from Mr MN Dunning on behalf of WPI and Mr MT Parker on behalf of the Crown.

WPI's position

Mr Dunning summarised the legal position in respect of my decision and the decisions in Tahorakuri as endorsed by Robertson J. Mr Dunning confirmed

that the courts have agreed there is a land owning entity and a forest owning entity and then emphasised the High Court decision which confirmed the land is to be valued as it actually was although recognising that the trees themselves are not included in the value of the land.

Mr Dunning also outlined the evidence presented at the original hearing from WPI, and in particular the briefs of evidence presented by Messrs Wood, McKinley and Reynolds. He then commented on the Crown's evidence presented at the original hearing and concluded that my award should support a deduction of \$125/ha over the whole forest and result in a new land value of \$6,923,000.

Crown's position

Mr Parker's submission was that in view of Richardson J's decision I should consider his comments and decide to what extent they are relevant in deciding whether as an issue of fact any adjustment to value should be made for pre-plant cost differences between Karioi and the pastoral sales evidence. He emphasised the need to recognise that the purpose of the exercise is to assess the price a purchaser would pay for land subject to the CFL and used for forestry purposes.

He then dealt with pre-plant cost adjustments, identified the differences between the Tahorakuri and Eyrewell decisions and submitted that a prudent purchaser would not take into account the pre-plant cost differences between forestry land and pastoral land. He submitted however, if they did they would use an NPV approach and a post tax approach should be used in completing the calculations.

Pre-plant costs at Karioi

The land at Karioi has been used for forestry over a number of years. It is all planted in forest and on inspection and based on the evidence at the hearing it is clearly evident there are costs to the licensee in clearing away debris and preparing the land for replanting after harvesting. Those issues were not in dispute.

The pre-plant costs are essentially divided into two principal operations. The first is the clearing away of the slash/debris of the previous crop, and the second the cultivation and mounding of the land to plant the new seedlings above the coldest ground frost levels.

The issue before me at both hearings was to consider to what extent the pre-plant costs that were incurred at Karioi would impact on the price a purchaser would pay for the land.

My conclusion

Richardson J emphasised that when considering land value I was to assess the land as it actually was at the commencement of the licence. He stated: "Depending on the factual situation this may or may

not require an adjustment for pre-plant costs, when using the put and take method."

The Tahorakuri decision proceeded to the Court of Appeal which directed the High Court to readdress the quantum of pre-plant costs in that case. In the High Court's second decision and as identified in my award the Court noted that any adjustment for pre-plant costs will vary from forest block to forest block.

They stated: "Where there are clear cost savings the adjustment from actual pastoral land state to assumed forest state may be significant. Where the distinction between the two states does not result in demonstrably pre-plant or weed control cost savings then the adjustment may be minimal or even non-existent. In our view the evidence accepted in this case should not lead to the conclusion that all pastoral land sales used for forest land comparison should be adjusted in the same manner and a case-by-case consideration of each of the factors affecting land value is required.

In the Eyrewell Decision, which is on land of similar contour to the subject, it was held that no pre-plant cost adjustment was necessary. The evidence before that Court confirmed that it was cheaper to plant in cut over forest land than in pastoral land.

That there are issues of pre-plant costs applicable in Karioi is not in dispute and the evidence was well presented. The licensee does incur costs between harvest and replanting. There was considerable debate as to whether those costs were tax deductible or needed to be capitalised. However, those issues would only be significant if I were satisfied that the market in establishing a land value at Karioi would make an additional deduction for pre-plant costs when comparing with the sales evidence used to establish value.

Identified on page 15 of my award is the value I adopted as a "starting point" after consideration of the evidence and inspection of the sales. That value was \$9,046,500. I then considered the adjustments required, if any, having regard to the evidence presented at the hearing.

That starting value was established after careful consideration of the market evidence. As confirmed in the final High Court Decision on Tahorakuri when applying the sales evidence to the land being valued there must be a case-by-case consideration of each of the factors affecting land value.

The sales evidence considered was principally pastoral land purchased by foresters for conversion to forestry. This differed from the evidence presented in the Tahorakuri case where much of the evidence was on pastoral to pastoral sales.

The principal purchaser through the King Country was Carter Holt Harvey but other purchasers included private investors and syndicates. There was not evidence presented to suggest that any of these

purchasers of land for forestry purposes were other than well informed.

It is my view that when adjusting sales evidence and applying that to the property being assessed care must be taken not to allow for adjustments which may already have been taken into account in the sales. Mr Reynolds, acting on behalf of the licensee confirmed that when making his adjustment for pre-plant costs he was relying on the decisions in Tahorakuri. The final conclusion in that case however, emphasised the need to consider the facts in each case. Just because pre-plant costs were accepted in Tahorakuri it would not necessarily follow that a deduction for pre-plant costs would be applicable in the subject case.

I raised this issue at the second hearing by asking the parties whether it was possible that when purchasers acquire pastoral land for conversion to forestry that any deduction for pre-plant costs was already factored into the price. It was Mr Parker's view that purchasers of pastoral land for conversion to forest take into account all forestry costs when determining price. Mr Dunning replied that there was no evidence that purchasers of pastoral land for forestry purposes did take pre-plant costs into account when establishing price.

In deciding to allow for pre-plant costs Mr Reynolds not only relied on the legal decisions of Tahorakuri but also on the evidence presented by the licensee of actual pre-plant costs in this forest. There was no evidence presented to me however, that those same costs or other similar pre-plant costs would not apply to the sales evidence used as a basis for assessment. The representatives of WPI confirm they did take pre-plant costs into account when determining what to pay for land. As all were well informed it would follow that the purchasers of the various blocks used a basis in the assessment also took those factors into account. Unless it can be clearly shown that the pre-plant cost issue was not taken into account in the sales evidence, it is my view that when making an additional deduction for pre-plant costs one may well be double counting.

The pre-plant costs at Karioi were divided into two sectors. One was the mounding of the land to plant slightly above the original ground level,

which is a feature of the land in this location and should be taken into account when considering the use of this locality for forestry purposes. I am satisfied that factor has been allowed for in the adjustments already made for location, contour and production when arriving at the starting value of just over \$9,000,000.

The second issue of clearing slash and debris, which is the other factor of pre-plant cost, could occur in all forestry situations. To make an additional adjustment for that purpose I would have required evidence to clearly establish that those same or similar costs would not be incurred on the sales evidence used as a basis for this assessment. This exercise was not done as confirmed by Mr Reynolds in his answers to Mr Parker's questions at the hearing.

There was no disagreement between the parties that the purchasers of the sales used as a basis for this assessment were other than well informed foresters who were purchasing pastoral land for conversion to forest. In absence of any clear evidence to the contrary one can only assume that those purchasers took all factors into account when acquiring land for conversion to forestry if pre-plant costs were relevant and not considered, then those purchases would immediately suffer a decline in value once they planted the land in trees. There was no evidence that situation applied in any of the sales all of which were negotiated freely on the open market on a willing seller/willing buyer basis.

Award

After consideration of the evidence presented at the original and second hearing, I am of the view that in this case the facts as presented to me would not justify an additional deduction for pre-planting costs. I therefore confirm the land value for the karioi forest as at November 1996 at \$8,100,000 (eight million one hundred thousand dollars).

K G Stevenson
Arbitrator

Note: This is the second award made in respect of this case, which relates to Crown Forest Licenses. The first award was included in The Valuers Journal, July edition 1999.

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ACKNOWLEDGEMENTS

Statistics New Zealand
www.stats.govt.nz

Quotable Valuations NZ
www.gvonline.co.nz

NZ Building Economist
PO Box 4127, AKLD

REINZ
www.reinz.org.nz

NZ Meat & Wool Boards'
Economic Service

Enquiries to:

The Chief Executive Officer, PO Box 27-340, Wellington Ph
(04) 384 7094, Fax (04) 384 8473
national@property.org.nz

sales statistics market analysis

(Source: Quotable Valuation NZ)

Number of sales recorded 2000

Cumulative sales

RENZ sales benchmarks

(Source: Real Estate Institute of New Zealand Property Market Report (www.reinz.org.nz))

Residential property statistics for January 2001 show residential values are improved on both last month and last year, and the total value of sales nationwide rose over the last month, from \$936,485,445 for December 2000 to \$994,952,763 in January 2001. The national median sales price rose \$5,000 to \$175,000, compared to \$170,000 in December 2000.

The national sales volume for January 2001 was 4741, rising from the 4611 sales in December. Sales however eased on a year to year basis, with 473 more homes changing hands in January 2000 than in 2001. Section activity and median section price decreased with 415 sections changing hands at a median price of \$81,000 compared to 459 sections sold during December at the median price of \$81,500.

Total *Dwellings Median Price Comparisons Median prices by district for Jan, Dec

REGION	SECTIONS			
	JAN99	JAN00	JAN01	JAN01
Northland	147,500	171,250	149,000	83,000
Auckland	230,000	230,000	240,000	115,750
Waikato/BOP/Gisborne	152,250	159,500	160,500	79,000
Hawkes Bay	125,250	125,000	136,000	43,000
Manawatu/Wanganui	102,000	99,250	105,000	26,500
Taranaki	94,000	93,000	106,500	25,250
Wellington	167,500	185,000	195,000	86,750
Nelson/Marlborough	140,000	140,000	152,000	92,000
Canterbury/Westland	145,000	147,000	142,000	71,500
Otago	90,000	95,000	109,000	60,500
Southland	89,000	72,000	106,000	100,000
NZ Total	\$164,000	\$169,250	\$175,000	\$81,000

*Dwellings include houses, units, townhouses, apartments, home and income, conversions and residential investment blocks.

Median Sales Prices

\$176,000
\$174,000
\$170,000
\$168,000
\$166,000
\$164,000
\$162,000
\$160,000
\$158,000

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TOTAL DWELLING SALES FOR JANUARY 1999-2001

REGION	Value of sales			
	JAN99	JAN00	JAN01	JAN 2001
NZ Total	6,409	5,214	4,741	994,952,763

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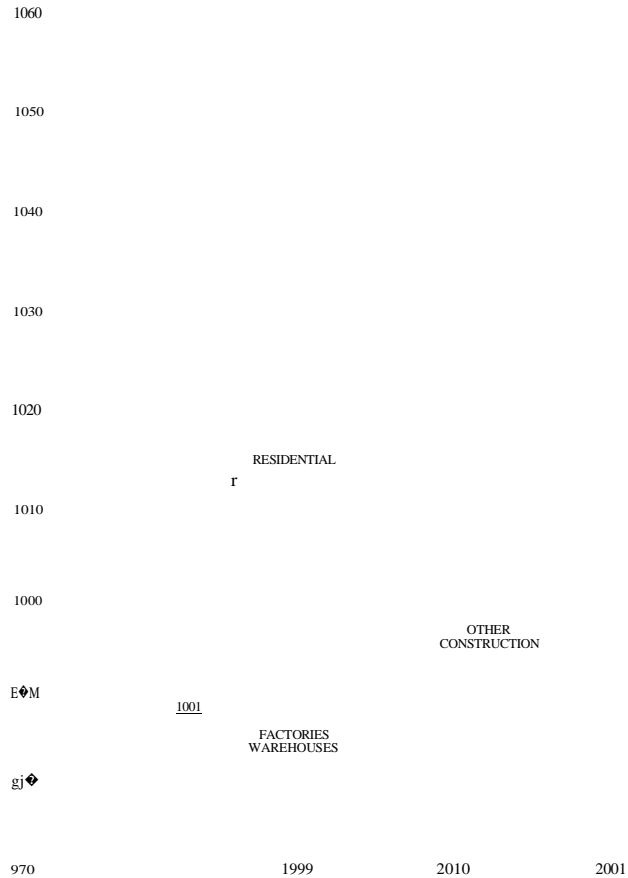
Building and construction cost indices

Source: *The NZ Building Economist* December 2000

NOTE - NEW ZERO BASE 1060

The information on these graphs is taken from indices produced by the Department of Statistics and is intended for use on a national basis. All are related to a base of 1000 in September 1999 and there is no GST content.

The projections given are based on forecasts developed from a variety of sources by our consultant but must be read and used as assessments only. No guarantee can be given for their accuracy though they are developed using patterns demonstrated by past achievement and anticipated market responses. The "Other Construction" graph line may vary considerably depending on what type of work is done during the period graphed.



Examples of use

1. A house completed in December 1998 cost \$920m². What would be the likely cost of a similar building due to be completed in December 1999?

$$\$920 \times \frac{1006}{996} = \$929m^2$$

2. A factory contract let in September 1998 for \$1,500,000 is due to be completed in June 1999. What might be the total figure for market fluctuations? (This will be influenced by the characteristics of each project and it is usually best for estimating purposes to always take the midline of index movements, i.e. 50%.)

Index movement 989 start 996 finish 996 - 989 = 7 x 50% = 3.5
 Therefore \$1,500,000 x $\frac{3.5}{989}$ = \$5308 (upwards)

(Check contract for fixed amount or market fluctuations)

Regional cost indices

Please note that these are gross assessments only and are for general interest and comparison rather than for quotation. They are, however, based on conditions current in each region at the time of publication of this issue.

Standard house specification

94m²; 3 bedroom; level site; timber pile base; fibre cement base lining with plastic vents; timber steps; fibre cement weatherboards; R 2.2 batts to walls, R 2.4 batts to ceilings; truss gable roof with ceiling battens; Zincolume roofing and accessories; aluminium joinery; particle board floor; Gib board to walls and ceilings; shower over bath; separate w.c.; separate laundry with s.s. tub and cupboard under; 12 lights; 16 power outlets; average quality wallpaper; conventional 4 element stove.

Executive house specification

House with upper storey. Refer to "The Exemplar House" for individual material and trade costings and for overall costs.

Bottom storey: 149m² including double garage, 2 bedrooms, bathroom, separate wc. and laundry, roofed over spaced timber deck and concrete front terrace.

Concrete floor to garage, timber elsewhere. Brick veneer. Upper storey: 46m² including bedroom, sifting room, walk in wardrobe and ensuite. Insulclad. Metal tile roof and accessories, metal fascia/gutter. R 2.2 batts to walls, R 2.4 batts to ceilings. Aluminium joinery. Gib board interior linings with taped and stopped joints. Acqualine to wet areas. Fittings and fixtures as detailed for "The Exemplar House".

	AUCKLAND	B.O.P WAIKATO	MANAWATU HAWKES BAY TARANAKI WANGANUI	WGTN	CHCH	DUNEDIN
Standard House average cost per m ²	955.00	870.00	835.00	910.00	810.00	835.00
Executive House average cost per m ²	1220.00	1100.00	1095.00	1130.00	1082.00	1086.00

Costs exclude GST

(The New Zealand Building Economist PO Box 4127 Auckland, Phone (09) 479 5099)

Costings

Idesidential Coatings

St Albans, Canterbury House, December 1999

Contributed by Canterbury-Westland Branch

Construction: Brick exterior, Colour Tile roofing, Beauty Board kitchen

Areas: 87m2 incl. garage of 22m2

Contract Price: \$77,000

Analysis:

Total: 87m2 \$885/m2 Modal Rate: \$923 Multiple: 0.96

Notes: Constructed by Affordable Homes Ltd. Stove supplied, shower over bath and internal decoration.

Belfast, Canterbury House, December 1999

Contributed by Canterbury-Westland Branch

Construction: Brick exterior, Colour Tile roof, Beauty Board kitchen.

Areas: 153m2 incl. Garage of 37m2

Contract Price: \$119,300

Analysis:

Total: 153m2 \$780/m2 Modal Rate: \$923 Multiple: 0.85

Notes: Constructed by Affordable Homes Ltd in the Mansfield style. Stove supplied, separate shower from bath, internal decoration. Share main drive.

Canterbury-Westland House, December 1999

Contributed by Canterbury-Westland Branch

Construction: Brick exterior, Colour Tile roof, Beauty Board kitchen.

Areas: 180m2 incl. Garage of 35m2

Contract Price: \$129,000

Analysis:

Total: 180m2 \$717/m2 Modal Rate: \$923 Multiple: 0.78

Notes: Constructed by Affordable Homes Ltd in the Pharlaph four single garage style, internal decoration.

Woodend, Canterbury House, December 1999

Contributed by Canterbury-Westland Branch

Construction: Brick exterior, Colour Steel roof, Beauty Board kitchen.

Areas: 170m2 incl. Garage of 36m2

Contract Price: \$125,000

Analysis:

Total: 170m2 \$735/m2 Modal Rate: \$923 Multiple: 0.80

Notes: Constructed by Affordable Homes Ltd in the Limerick four-garage style. Separate shower and ensuite from bath, internal decoration.

Hamilton - House, February 2001

Contributed by Steve Newton, Clear

Construction: Timber piles with fibrolite cladding

Areas: 94m2

Contract Price: \$90,463

Analysis:

Total: 94m2 \$962/m2 Modal Rate: \$900 Multiple: 0.95

Notes: A Keith Hay group type dwelling. Cost is net after deduction of cost of deck (\$3,000), wood burner (\$1,700), carpet (\$3,500) and demolition of old dwelling (\$4,162). Dwelling built to replace fire damaged one.

Harewood, Canterbury House, October 2000

Contributed by Bill Patterson, Christchurch

Construction: Concrete foundation and floor, brick veneer, timber framing, aluminium joinery, Gibraltarboard interior linings, Colour Steel roof, Colour Steel spouting

Areas: 159m2 incl. Garage of 31m2

Contract Price: \$122,500

Analysis:

Total: 159m2 \$770/m2 Modal Rate: \$934 Multiple: 0.82

Notes: 3 bedroom, 2 toilets, double garage that includes the laundry to the side with a Super Tub. Wired for heat pump, night store and security system.

Fendalton, Christchurch Town House (2),

February 2001

Contributed by Bill Patterson, Christchurch

Construction: 2 storey concrete foundation and ground floor, wooden 1st floor. Rockcote over polystyrene wooden frame, Coloursteel roof and spouting.

Plasterboard, double glazing, gas fireplace, tiled bathroom, ensuite, Super Tub twin ss sink.

Formica bench and breakfast bar, 3 toilets, 4 bedrooms, dining/living, kitchen, double garage with auto door.

Areas: 277m2

Contract Price: \$140,000

Analysis:

Total: 277m2 \$504/m2 Modal Rate: \$945 Multiple: 0.53

Notes: Both units are the same, all bedrooms and bathrooms are on the top. The master bedroom has a walk in wardrobe, the other 3 double rooms have double built in wardrobes. Facing well to the sun.

West Melton, Canterbury Rural Dwelling, March 2001

Contributed by Bill Paterson

Construction: Concrete foundation and floor, top floor chipboard. Timber frame, double glazing, aluminium joinery Coloursteel roof. Internal walls lined with straw and plaster interior.

Areas: 167m²

Contract Price: \$120,000

Analysis:

Total: 167m² \$719 Modal Rate: \$945 Multiple: 0.76

Notes: 1 single, 1 double bedroom, large storage laundry, large office, small bathroom, open plan kitchen/dining/living.

Commercial Ctsslings

Rotorua Doctors' Surgery, February 1999

Contributed by Grant Utteridge, Reid and Reynolds Ltd.

Construction: Concrete foundations and floor slabs, batted Hardiflex walls, aluminium joinery, Coloursteel roof, plasterboard walls.

Areas: 76m²

Contract Price: \$55,066

Analysis:

Total: 76m² \$724/m² Modal Rate: \$870 Multiple: 0.83

Notes: Detached doctor's surgery with 3 offices, reception area, kitchen, bathroom and store area built into existing adjoining garage.

Nelson Truckwash, July 1999

Contributed by Gowans Valuation, Nelson.

Construction: Sloping concrete slab base to sump, raised wooden walkway to side with 2m corrugated iron fence adjoining. Two floodlights on tanalised poles.

Areas: 114m²

Contract Price: \$14,000

Analysis:

Total: 114m² \$123/m² Modal Rate: \$870 Multiple: 0.14Nelson Industrial Office Block, July 1999

Contributed by Gowans Valuation, Nelson.

Construction: Single storey, concrete block foundation, concrete floor slab, timber frame, brick veneer, aluminium windows, Coloursteel roof. Wired in ply to dado, Gibraltarboard over and on ceilings.

Areas: 378m² incl. Deck of 82m²

Contract Price: \$140,068

Analysis:

Offices: 296m² \$425/m² Modal Rate: \$870 Multiple: 0.49Deck: 82m² \$174/m² Modal Rate: \$870 Multiple: 0.20

Notes: Reception/administration area, general administration office, 7 offices, boardroom, paraplegic standard toilet, staff room with kitchen, dual toilet amenities, deck on two sides.

Nelson Industrial Office Block, July 1999

Contributed by Gowans Valuation, Nelson.

Construction: Single storey, concrete slab, timber frame, plaster cladding, aluminium joinery and iron roof over.

Areas: 465m²

Contract Price: \$231,000

Analysis:

Total: 465m² \$496/m² Modal Rate: \$870 Multiple: 0.57

Note: 12 partitioned offices, reception area, records room, dual toilets and shower, conference room, staff room with kitchen, excludes fit out.

North Canterbury Shopping Centre, August 1999

Contributed by Rolle Hillier Parker and Bennett Rolle Ltd., Christchurch

Construction: Corrugated iron roof, plaster and vertical weatherboard cladding, timber verandah to street frontage (19m²), glazed and concrete entry canopy (18m long) with steep portals at 3.6m.

Areas:

Contract Price: \$650,000

Note: 2-storey development, 3 shops (144m²) to ground floor, 1 cafe (178m²), and 3 residential apartments (240m²) to first floor.

Rural CoOngs

Southland Hay Barn, April 1999

Contributed by Ah-Lek Tay, Barlow Justice

Construction: Galvanized iron to three sides, steel frame, and earth floor.

Areas: 108m²

Contract Price: \$12,200

Analysis:

Total: 108m² \$113/m² Modal Rate: \$785 Multiple: 0.14

Notes: No power, 3.65 metre stud.

Miscellaneous Coatings

Remuera, Auckland Lift, January 2000

Contributed by Munroe Graham, Auckland Valuation Services

Construction: The Price cover supply and installation (within an existing lift well provided when the building was originally designed) with the following specifications:

Three persons/350kg, speed 0.1ms, hydraulic, two levels, single entry. Interior dimensions 1.2m x 1.2m by 2.2 m, melamine and carpet tile finishes, low noise power unit (single phase).

Areas: 1.44m²

Contract Price: \$26,090

Nelson Fuel Tank Bunker, December 1998

Contributed by Gowans Valuations, Nelson

Construction: External fuel tank bunker with concrete slab foundations, 150mm concrete block walls to 800mm concrete cradle for tank.

Areas: 10m2

Contract Price: \$2,800

Analysis:

Total: 10m2 \$280/m2 Modal Rate: \$860 Multiple: 0.33

Notes: Excludes tank and fittings.

Dunedin Retrofitting of Sprinklers to Bar, September 1999

Contributed by Richard Miller Barlow Justice

Construction: Relates to the retrofitting of a sprinkler system into a 2 storey structure comprising of a bar with offices above. In the bar the sprinklers are exposed i.e. open roof trusses creating a clear span space with the pipe work in full view and no ceilings. Only 5% of the office area has ceilings.

Areas: 868m2

Contract Price: \$45,000

Analysis:

Total: 868m2 \$52/m2 Modal Rate: \$870 Multiple: 0.06

Notes: The building was constructed in the 1930s and has subsequently been renovated with plaster over the brick, concrete floor and wood roof framing.

North Island Youth Hostel Association, August 1999

Contributed by Rolle Hillier Parker and Bennett Rolle Ltd.

Construction: 4 level fit out development to existing office building. 2 floors bedrooms and ablutions (1085m2). Carpet/vinyl flooring, Gibraltarboard walls and ceilings, standard fittings. 1-floor

administration/kitchen/dining areas (542m2). Carpet/vinyl flooring, stainless steel fittings, Gibraltarboard walls and ceilings, high concentration of wet fittings (laundry/kitchen etc). 1-floor

lounge/TV room facilities (1200m2). Carpet flooring, Gibraltarboard walls and ceilings.

Areas: 2,827m2

Contract Price: \$818,000

Analysis:

Total: 2,827m2 \$290/m2Christchurch Working Men's Club Toilets/Entry, August 1999

Contributed by Rolle Hillier Parker and Bennett Rolle Ltd.

Construction: Alter and extend existing toilets and entry to carpet. Remove existing mens/female wcs and replace in new location, with new fittings. Tiled floor, Melamine walls, Gibraltarboard ceilings. Replace existing entry structure with new inverted curved roof, Butynol, plaster cladding with two plastered columns.

Areas: 92m2

Contract Price: \$167,000

Analysis:

Total: 92m2 \$1,815/m2Christchurch Appliance Shop Extensions, August 1999

Contributed by Rolle Hillier Parker and Bennett Rolle Ltd.

Construction: Alter and extend (198m2) existing retail premises, and create new facade to street. Tiled floors, timber framed columns, Gibraltarboard walls and ceilings. New mezzanine floor for offices and new shop front glazing to width of facade (15.5m).

Areas: 213.5m2

Contract Price: \$230,000

Analysis:

Total: 213.5m2 \$1,077/m2Christchurch Residential Alterations, August 1999

Contributed by Rolle Hillier Parker and Bennett Rolle Ltd.

Construction: Alterations to existing house, building 2 attic bedrooms and bathroom into existing roof space. Gibraltarboard walls and ceilings, tiled bathroom, carpet flooring. Sky lighting and bi-folding windows.

Areas: 73m2

Contract Price: \$49,750

Analysis:

Total: 73m2 \$682/m2Christchurch Residential Alterations, August 1999

Contributed by Rolle Hillier Parker and Bennett Rolle Ltd.

Construction: Alterations to existing house, extending family room and bathroom, new laundry and kitchen, new bay window, timber joinery and floors.

Areas: 18m2

Contract Price: \$27,000

Analysis:

Total: 18m2 \$1 500/m2 Modal Rate: \$921 Multiple: 1.63West Melton, Canterbury Septic Tank, March 2001

Contributed by Bill Patterson

Construction: Clearwater Z54 McKindrys Z5000 Tank System. 1440l/day capacity (up to 5 bedrooms), including pump and stormwater drains etc. 4mm holes @ 1cm centers. 19.2 in in length covered with 30mm PVC pipe with filter cloth.

Contract Price: \$7,690 (incl GST)

Hot off the press

News from Statistics New Zealand

Building Consent Statistics

	October 2000	November 2000	December 2000
New Dwelling Units			
Number of new dwelling units	1585	1700	1285
Average consent value per unit	\$146,057	\$146,353	\$160,311
Non-residential buildings			
Consent value (Total)	\$217.1m	\$270.2m	\$214.6m
Consent value all buildings			

Building consents issued

December 2000 Highlights

- Number of new dwellings fall

There were 1285 new dwelling units authorised in December 2000. This is the lowest number of new dwelling units authorised in any month since January 1992. There were 1585 new dwelling units authorised in October 2000 and 1700 new dwelling units authorised in November 2000.

- Regional results

In December 2000 there were 450 new dwelling units authorised in the greater Auckland region. This compares to 536 new dwelling units authorised in October and 650 new dwelling units authorised in November 2000.

- Non-residential buildings

The value of non-residential building consents issued for December 2000 was \$214.6 million. This follows \$217.1 million issued in October and \$270.2 million issued in November 2000. However, the trend in the value of consents issued for non-residential buildings has been increasing since April 1999.

Retail trade survey

December 2000 Highlights

- National sales - December 2000 month
Seasonally adjusted sales for the December 2000

month were \$3,719 million, an increase of 1.0% when compared with November 2000. Excluding the motor vehicle services and retailing store types, seasonally adjusted sales increased by 1.2%.

- Store type sales - December 2000 month

Eleven of the 15 store types had increases in seasonally adjusted sales this month, compared with November 2000. The largest increase was in motor vehicle retailing (\$16 million) followed by clothing and soft goods (\$11 million) and food retailing (\$10 million).

- National sales - December 2000 quarter

Seasonally adjusted sales for the December 2000 quarter were \$11,041 million, an increase of 0.9% when compared with the September 2000 quarter. With inflationary effects removed seasonally adjusted sales fell by 0.5%, suggesting that price changes were more significant than sales volume during the December 2000 quarter. This is the first decline in volume since the March 1998 quarter.

- Store type sales - December 2000 quarter

Major contributions to the increase this quarter came from food retailing, up 2.2% (\$56 million) and cafes, restaurants and takeaways, up 2.9% (\$22 million). A 0.7% decline in motor vehicle services (\$11 million) partially offset the increase.

Monthly Retail Trade

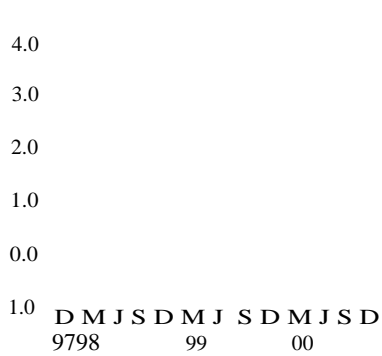


Consumers Price Index

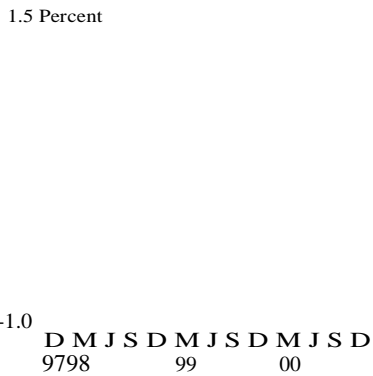
December 2000 quarter Highlights

- CPI rises in the December quarter
The CPI rose by 1.2% in the December 2000 quarter after rising 1.4% in the September quarter.
- Annual increase in the CPI
There was an annual increase of 4.0% from the December 1999 quarter to the December 2000 quarter.
- International airfares make largest single item contribution to the CPI
An increase in the price of overseas air travel of 5.6% made the largest single contribution to the CPI in the December quarter.
- Widespread price increases
Price rises were widespread this quarter but there were fewer significant upward item contributions than in the September quarter, where price increases for petrol, and cigarettes and tobacco accounted for much of the quarterly increase. Of the nine groups in the CPI, eight recorded increases in the December quarter while the credit services group recorded no change.

Consumers Price Index
Annual percentage change



Consumers Price Index
Quarterly percentage



Capital asset prices increase

The Capital Goods Price Index (CGPI) All Groups Index rose 2.2% in the December 2000 quarter. This follows a 1.1% increase in the September 2000 quarter. The All Groups index has increased for seven consecutive quarters. All asset types increased this quarter.

- Plant, machinery and equipment and transport equipment prices rise
The prices of imported capital items strongly influenced indexes for both, plant, machinery and equipment, and transport equipment. The plant machinery and equipment index rose 4.1 % in the December 2000 quarter. This follows a 1.9% increase for the September 2000 quarter. The December quarter's increase was largely influenced by other special purpose machinery, which increased 9.4% this quarter (higher printing machinery prices were a

Gross Domestic Product

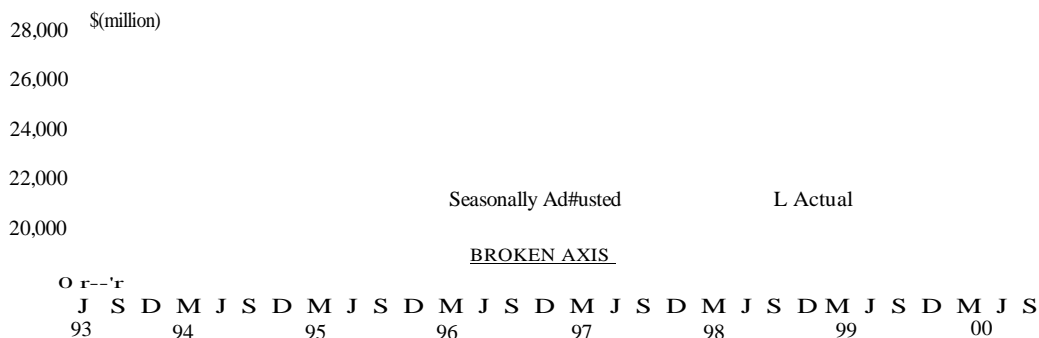
September 2000 quarter Highlights

- Economy recovers
Economic activity increased 0.7% in the September quarter. This follows a 1.0% fall recorded in the June quarter. For the year to September, the economy grew 4.5%.
- Agriculture and manufacturing up
The largest rises occurred in agriculture and in manufacturing. Energy also recorded growth, but the

picture across the service industries was mixed with both rises and falls occurring.

- New series
This release contains estimates for production-based GDP only and is the first 'live' release of the chain-volume series, expressed in 1995/96 prices. The constant price series for expenditure-based GDP (GDE) still has to be converted to a chain-volume series. These series will be published prior to the December 2000 quarter release due out on 30 March.

Quarterly Percentage Change in GDP in Constant Price
Seasonally Adjusted



Statistical publications received

*NZ Meat & Wool Boards' Economic Service
New Season Outlook 2000-01, Dec 2000 PO
Box 5179,
Wellington
Overview reproduced by permission*

Economic growth

NZ economy growing and Pastoral exports up

The New Zealand economy is forecast to grow 3.8% for the calendar year 2000 and grow a further 3.5% in 2001. This growth is underpinned by the export sector and includes gains in the pastoral sector following an excellent season with good levers of animal production. This is further underpinned by the general improvement in world commodity prices and an export favourable exchange rate.

However, business confidence is at variance with this trend and has been upset by government moving its focus from a neutral position to where society issues dominate over business issues. This has led to business uncertainty.

Interest and exchange rates

Reserve Bank OCR

The Reserve Bank has kept upward pressure on interest rates to dampen inflation pressure by revising its Official Cash Rate upwards four times in the first six months of 2000.

90 day rates peak at 7.3%

Key indicator 90-day interest rates are estimated to peak in December 2000 at 7.3%. This translates to around 9.5 % for seasonal overdraft finance and around 9 % for term finance. Annual average inflation rates are expected to increase to around 2.2% for the current and following year, the highest since 1996.

Exchange rate forecast up

Though the NZ exchange rate in US dollar terms reached a 15 year low in the last week of May 2000 the price estimates used in this paper have been based on a higher exchange rate similar to the level that prevailed for much of 1999-00.

On this basis the prices estimates and farm revenue estimates for 2000-01 were made using exchange rates of 51 to 53 cents US and 31 to 32 UK pence to the NZ dollar

Wool exports

\$ 784 million +1%

The general outlook for wool price is for more of the same but with upside potential. The upside prospect comes from increased economic growth in the EU, USA, Asia and commodity prices in general lifting. The 1999-

00 end of season upturn in wool prices reflected' the NZ dollar depreciation at that time and renewed demand for wool from China.

Lamb exports
\$1.89 billion +2%

The outlook for lamb remains buoyant. The EU sheep flock decreased 2.3% in 1999 and this is expected to keep prices firm. The EU is the largest market region for lamb followed by the Middle East then North America. Lamb exports to North America have a larger component of high value chilled and frozen lamb products compared with other market regions. Lamb exports for 2000-01 are estimated to total \$1.89 billion (+2.2%).

Lamb carcasses 11%

Frozen carcass shipments made up 11% of lamb exports in 1999-00 and contrasts with frozen carcasses making up 82% of shipments 20 years ago.

Lamb cuts 76%

Higher value frozen cuts and boneless lamb product made up 76% of shipments in 1999-00.

Chilled lamb 13%

High value specialised chilled lamb shipments made up 13% of exports in 1999-00, an increase of 1 %age point on the previous year.

Beef exports
\$1.86 billion +8%

Beef exports for the year to 30 June 2000 increased 9% on the previous year and show a further increase of 6% to 30 June 2001. The export price per tonne increased 17.5% for 1999-00 and is expected to increase 2.3% for 2000-01. Higher beef prices are driven from the US market as their supply falls from cattle held to rebuild their herd. Beef exports for 2000-01 are estimated to total \$1.86 billion (+8.2%).

Sheep down ewes static

Sheep numbers at June 30, 2000 decrease 3.6% but breeding ewe numbers remain almost static (+0.301o). The outlook to June 30, 2001 is for sheep numbers to decline 1.4%.

Lamb crop up

With sheep in good condition the expectation is for an excellent lamb crop in the spring of 2000, up 1.4% to 35.2 million, based on a national lambing %age of 115.5%.

Beef cattle

+4.9%

Beef cattle numbers increase 4.9% to June 30, 2000 and 2.1% to June 30, 2001 as the herd continues to be rebuilt to the pre drought level. Dairy beef calf numbers retained in the spring of 2000 are similar to the previous year.

Dairy cattle similar

Dairy cattle numbers at June 30, 2000 increased marginally by 0.7 reflecting the moratorium on new dairy production.

Sheep and Beef Farm

Per farm revenue and profit

(\$ Per Farm) 1999-00p 2000-01e % Gross Farm

Revenue

199,700 199,100 -0.3 Total Farm Expenditure

153,300 153,900 +0.4

Farm Profit Before Tax 46,400 45,200 -2.6

Farm revenue holds

Sheep and beef gross farm revenue for 2000-01 is expected to remain unchanged (-0.3%) on the previous year. This situation comes from estimated lighter per head slaughter weights than last season's

record that largely offset good price levels. Farm expenditure remains constant (+0.4%).

Farm profit eases

The combination of the above factors results in farm profit before tax decreasing 2.6% to \$45,200 per farm. This is 14.9% above the average of the 1990s in inflation adjusted terms. In context, the 1990s were difficult to farm through with farm profit for the decade the lowest in inflation adjusted terms of any decade since the 1950s.

Farm profit before tax has to cover debt reduction, capital purchases, farm family drawings and tax.

Regional Comme

Benign climate would boost profit

Clearly a repeat of the 1999-00 favourable climate would boost production, farm revenue and profit. Two good years in a row would be excellent but not likely. For this reason the outlook for 2000-01 has used high but not top performance.

Exchange rate

A sustained 5% currency depreciation would boost gross farm revenue \$15,500 (+8%), and a 5% appreciation would cut \$12,700 (-6%) from Gross Farm Revenue.

Publications received

(Source Statistics New Zealand)

Number and total sale price freehold open market sales by urban categories half year ended June 2000*

	Main Urban Areas		Rest of New Zealand		Total New Zealand	
	No.	Total Sale Sales Price (\$M)	No.	Total Sale Sales Price (\$M)	No.	Total Sale Sales Price (\$M)
Sections	1926	198.9	1433	104.9	3359	303.7
Houses	17512	3701.6	9531	1334.7	27043	5036.3
Home and Income Ownership Flats	179	59.0	55	11.6	234	70.6
Purpose-Built Flats	4415	764.1	1381	166.6	5796	930.7
Houses Converted To Flats	205	63.0	101	15.5	306	78.5
Vacant Commercial	166	42.0	31	3.2	197	45.2
Improved Commercial	14	9.5	18	4.5	32	14.1
Vacant Industrial	433	435.2	282	129.6	715	564.9
Improved Industrial	119	31.6	60	7.3	179	38.9
Other Urban	546	244.0	185	40.4	731	284.4
	122	36.5	114	14.9	<u>236</u>	<u>51.3</u>
Total	25637	5585.3	13191	1833.3	38828	7418.6

*Provisional Data

Selling prices exclude chattels and other considerations

Rural Price Indexes

(Note: These include Farm Units and Non-Farm Units)

Half Year Ended	June		Dec		June	
	<u>1998</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>	<u>2000</u>	<u>2000</u>
OV PRICE INDEX						
Dairy Land	2110	2287	2210	2227	2275	
Percentage Change	-5.0	+8.4	-3.4	+0.8	+2.2	
Fattening Land	2301	2200	2328	2311	2336	
Percentage Change	-0.3	-4.4	+5.8	-0.7	+1.1	
Grazing Land	2452	2125	2315	2377	2575	
Percentage Change	+0.4	-13.3	+8.9	+2.7	+8.3	
Arable Land	3382	3145	3093	3159	3260	
Percentage Change	+2.9	-7.0	-1.7	+2.1	3.2	
Horticultural Land	2037	2021	2139	2235	2216	
Percentage Change	+4.5	-0.8	+5.8	+4.5	-0.9	
Total Rural*	2192	2224	2243	2256	2268	
Percentage Change	-3.4	+1.5	+0.9	+0.6	+0.5	

*Includes minor categories

Price Index Base: Half year ended December 1989 (=1000)

Rural sales by category freehold open market sales

Halfyear ended June2000

RURAL CATEGORY		NUMBER OF SALES		TOTAL SALE PRICE	
			%	\$ (000)	%
Arable	Units	4	18%	2,860	32%
	Other	18	82%	5,947	68%
	Total	22	100%	8,807	100%
Dairy	Units	182	71%	165,692	85%
	Other	75	29%	28,494	15%
	Total	257	100%	194,186	100%
Horticultural	Units	84	46%	35,031	58%
	Other	97	54%	25,751	42%
	Total	181	100%	60,782	100%
Fattening	Units	186	39%	138,799	62%
	Other	296	61%	84,296	38%
	Total	482	100%	223,095	100%
Grazing	Units	44	45%	27,085	74%
	Other	54	55%	9,338	26%
	Total	98	100%	36,423	100%
Specialist Livestock	Units	23	42%	12,059	57%
	Other	32	58%	8,988	43%
	Total	55	100%	21,047	100%
Total Farmland	Units	523	48%	381,525	70%
	Other	572	52%	162,814	30%
	Total	1095	100%	544,339	100%

MINOR RURAL CATEGORIES

		1		35	
Forestry	Vacant	11		2,202	
	Improved	17		2,351	
	Total	28		4,553	
Mining		1		6	

Total Rural

Sale prices exclude chattels and other considerations

Key financial statistics

Source Department of Statistics (Key Statistics) December 2000

Summary of Prices and Wages Index Numbers

Index Numbers and Percentage Change (1)

Base: June 1999 Quarter (=1000) (2)

Quarterly	CONSUMER PRICE INDEX				% CHANGE		PRODUCERS PRICE INDEX	
	Food	Non-Food	Grouped	Food	Non-Food	Change	Change	
1997 Sept	959	992	0.3	0.0	972	0.5	995	0.5
Dec	959	997		0.0	977	0.5	1000	0.5
1998 Mar	974	999	1.0	0.2	980	0.4	996	-0.4
June	992	1004	0.7	0.5	980	0.6	1003	0.7
Sept		1009	1.4	0.5	990	0.4	1003	1.4
Dec	938	1101	0.0	-0.8	994	0.4	1101	-0.2
1999 Mar	1000	998	0.8	4.3	1000	0.4	994	-1.7
June	1000	1000	-0.0	0.2	1000	0.3	1000	0.1
Sept		1104	-0.6	0.0	1005	0.5	1014	1.4
Dec	990	1006	-0.4	0.2	1008	0.4	1029	1.5
2000 Mar	1094	101	1.4	0.0	1012	0.4	1043	1.4
June	1000	1	-0.4	0.7	1016	0.4	1055	1
Sept	101	1004	1.2	1.4	1	0.4	1095	1.8

(Key Statistics table 6.01)

- Change from previous quarter, calculated using index numbers on the original base for that index series
- June 1999 quarter is the weighting base of the CPI. For comparative purposes other series have been converted to this base from their original bases.
- Replaced the Prevailing Weekly Wage Rates Index.
- From the September 1999 quarter residential sections and interest are excluded.

Interest Rates, Yields, etc.

(Key Statistics table 9.03)

Monthly	Bank Bills 1			Government Stock Yield on			First Mortgage Base	
	Call	Days 30	Days 90	1 Year	2 Year	5 Year	Housing Lending Rates 2	Rates
1998 Nov	3.6	4.2	4.5	5	5.2	5.5	6.5	8.9
Dec	3.5	4.2	4.4	4.8	5	5.3	6.5	8.6
1999 Jan	3.4	4	4.5	4.9	5.1	5.4	6.5	8.6
Feb	3.3	4	4.3	4.7	5	5.4	6.5	8.6
Mar	4	4.5	4.6	4.4	5	5.4	6.5	8.4
April	4.5	4.6	4.6	4.1	4.8	5.4	6.5	8.4
May	4.5	4.6	4.7	4.1	4.9	5.7	6.5	8.4
June	4.5	4.7	4.8	4.4	5.3	6.2	6.5	8.4
July	4.5	4.6	4.7	4.5	5.2	6.1	6.5	8.4
Aug	4.5	4.6	4.8	5.1	5.7	6.5	6.5	8.4
Sept	4.5	4.7	4.9	5.8	6.2	6.9	6.5	8.5
Oct	4.5	4.7	5.1	5.8	6.3	7.1	6.7	8.6
Nov	4.7	5.1	5.4	5.9	6.3	6.8	6.7	8.6
Dec	5	5.4	5.7	6.1	6.6	7	7.2	8.8
2000 Jan	5.1	5.3	5.7	6.3	6.9	7.3	7.6	9.3
Feb	5.3	5.5	5.9	6.7	7.1	7.2	7.6	9.3
Mar	5.5	6	6.3	6.7	7	7	8.1	9.7
April	5.8	6.2	6.5	6.7	6.9	6.9	8.1	9.9
May	6.2	6.6	6.8	6.9	7.1	7.1	8.6	10.4
June	6.5	6.7	6.9	7	7	6.9	8.8	10.6
July	6.5	6.7	6.8	8.8	6.8	6.7	8.8	10.6
Aug	6.5	6.6	6.7	6.7	6.8	6.7	8.7	10.6
Sept	6.5	6.6	6.7	6.8	6.8	6.8	8.5	10.6
Oct	6.5	6.6	6.6	6.7	6.7	6.7	8.5	10.6

(1) Monthly Averages

(2) Prime rate for new borrowers. Based on total lending outstanding for housing purposes of major providers of housing finance.

(3) Base lending rates for major trading banks, weighted according to each institution's total NZ dollar claims on the private sector.

SIGNIFICANT ECONOMIC INDICATORS IN SUMMARY DECEMBER 2000

Population

As at 30 September 2000 (R)
3,836,500

estimated resident population

Births

December 2000 Quarter
14,017
-214

change from previous quarter

Deaths

September 2000 Quarter
7,186
636

change from previous quarter

Migration

October 2000
372

Permanent and long-term

Retail Sales

September 2000 Quarter (E)
0.1%

September 1999 Quarter (R)
2.4%

Per capita retail sales in March quarter 1995 dollars, seasonally adjusted % change on previous quarter.

CPI

September 2000 Quarter
1.4%

change from previous quarter

September 2000 Quarter
3.0%

change from same quarter previous year

Modal house costs (excl GSA)

Branch Statistical Officer/Chair	Modal March 2000	Modal March 2001
NORTHLAND John Schellekens 09 438 9599	948.87	971.28
AUCKLAND John Darroch 09 486 1677	958.45	981.09
WAIKATO Graham Cook 07 838 3353	944.07	966.37
GISBORNE Roger Kelly 06 868 8596	910.53	932.04
TAURANGA Brian Doherty 07 578 6456	886.57	907.51
ROTORUA Dave Townsend 07 348 4086	915.32	936.94
HAWKES BAY Boyd Gross 06 876 6401	904.57	924.91
TARANAKI Frank Hutchins 06 757 5080	895.15	915.28
CENTRAL DISTRICTS Ian Shipman 06 323 1447	904.57	924.91
WELLINGTON Bryan Wareham 06 378 6672	942.26	963.45
NELSON/MARBOROUGH Ian McKeage 03 546 9600	947.70	958.84
CANTERBURY/WESTLAND Mark Dow 033740115	933.69	944.67
SOUTH & MID CANTERBURY Rodney Potts 03 688 4084	961.70	973.01
OTAGO Shari Liebergreen PO Box 12 042 Dunedin	915.97	928.47
SOUTHLAND Trevor Thayer 03 218 4299	934.29	947.04

Definitons 1996

The Modal House is James Hardie Frontier Weatherboard 245mm, wood grain finish cellulose cement weatherboard, over timber frame on spaced timber pile foundation with baseboards. Roof is prefinished Colorsteel corrugated profile 15° slope, with gables. Aluminium joinery, 3 double bedrooms, combined open plan living/dining/kitchen, separate laundry, separate WC, bathroom with shower cubicle, free standing solid fuel heater, 19 light points, 19 power points, Melteca finished kitchen joinery, 4 plate automatic range. Floor area 100'

A full schedule of quantities, plans and specifications is available from NZPI, PO Box 27-340, Wellington, NZ.

Modal house costs

The Modal House cost is determined by the institute's consultant quantity surveyors, Rawlinson and Co Ltd, construction cost consultants and quantity surveyors, based upon the institute's 1996 Modal described.

Note values are based on normal accepted margins, and differing commercial conditions should be reflected by a suitable adjustment to the Modal value.

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